

Calendar No. 215

100TH CONGRESS }
1st Session }

SENATE

{ REPORT
100-105

SECURITIES AND EXCHANGE COMMISSION AUTHORI-
ZATION OF APPROPRIATIONS AND TECHNICAL
AMENDMENTS TO THE SECURITIES LAWS

R E P O R T

OF THE

COMMITTEE ON BANKING, HOUSING,
AND URBAN AFFAIRS
UNITED STATES SENATE

TO ACCOMPANY

S. 1452

together with

ADDITIONAL VIEWS



JULY 9 (legislative day, JUNE 23), 1987.—Ordered to be printed

U.S. GOVERNMENT PRINTING OFFICE

91-010

WASHINGTON : 1987

5243-7

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SECURITIES AND EXCHANGE COMMISSION AUTHORIZATION OF APPROPRIATIONS AND TECHNICAL AMENDMENTS TO THE SECURITIES LAWS

JULY 9 (legislative day, JUNE 23), 1987.—Ordered to be printed

Mr. PROXMIRE, from the Committee on Banking, Housing, and Urban Affairs, submitted the following

REPORT

together with

ADDITIONAL VIEWS

[To accompany S. 1452]

INTRODUCTION

The Senate Committee on Banking, Housing, and Urban Affairs to which was referred this bill (S. 1452), to amend the Securities Exchange Act of 1934 to authorize amounts to be appropriated for the Securities and Exchange Commission ("SEC" or "Commission") for fiscal years 1988 through 1989 and to provide for technical amendments to the securities laws, approved the bill on June 24, 1987, reports favorably thereon and recommends that the bill do pass.

PURPOSE OF THE LEGISLATION

The bill would amend Section 35 of the Securities and Exchange Act of 1934 ("Exchange Act") to provide the SEC with authorizations of \$158,600,000 in fiscal year 1988 and \$172,200,000 in fiscal year 1989.

The bill also provides for technical amendments to the securities laws.

AUTHORIZATION

HEARINGS

The Securities Subcommittee of the Senate Committee on Banking, Housing, and Urban Affairs, held a hearing on the SEC's budget authorization request on May 13, 1987. Testimony was received from: John Shad, Chairman of the SEC; William Anderson, the General Accounting Office's Assistant Comptroller General for General Government Programs; and Edward I. O'Brien, President of the Securities Industry Association.

The Subcommittee also held hearings on February 24, 1987 concerning the capital markets and the issue of the adequacy of the SEC's resources was raised by a number of witnesses. Testimony was received from: Donald B. Marron, Chairman and CEO, Paine Webber Group, Inc.; Raymond A. Mason, Chairman and CEO, Legg, Mason, Wood, Walker, Inc.; Robert P. Ritterreiser, President and CEO, E.F. Hutton Company, Inc.; Alvin V. Shoemaker, Chairman, The First Boston Corporation; Milton H. Cohen, Partner, Schiff, Hardin & Waite; Harvey L. Pitt, Partner, Fried, Frank, Harris, Shriver & Jacobson; and James C. Treadway, Partner, Baker & Botts.

THE NEED FOR THE LEGISLATION

The Subcommittee recognizes the value of a 3 year authorization to the planning and budgeting functions of an agency. However, the expanding responsibilities and workload of the Commission as well as recurring revelations of improprieties in the financial markets cast doubt on the wisdom of making a 3 year appropriation in today's environment. The Subcommittee believes that it should have greater involvement in overseeing the SEC's operations and be postured to provide a quick response to issues that could impact Commission resource needs. In addition, as explained more fully herein, the Subcommittee is concerned about the lack of growth in SEC resources since 1981 relative to the enormous growth in the volume and complexity of the securities markets during the same period. Accordingly, the Subcommittee believes a 2 year authorization is appropriate.

The Subcommittee recognizes the efforts of the Commission to operate responsibly during a period of budget austerity. The 3 percent staff growth since 1981 is in sharp contrast to the SEC's regulatory environment in the same period:

- the number of shares traded on the New York Stock Exchange increased 186 percent;
- the number of investors grew by 46 percent;
- registered investment companies and advisers increased 86 percent;
- registered broker-dealers increased by 57 percent; and,
- the number of full disclosure filings grew by 35 percent.

The Subcommittee is concerned that the SEC's authorization request for the next three years emphasizes anticipated new demands on the Commission without sufficient attention to the adequacy of existing resources to meet this enormous increase in regulatory demands. The areas identified in the SEC's request, such as resource

demands related to the internationalization of the securities markets and the needs of the SEC pursuant to any statutory realignment of regulatory authority over bank securities activities, may well impact future budget demands and should certainly be part of the Commission's budget planning. However, it appears to the Subcommittee that the SEC's resources may be spread too thinly in the current regulatory environment and that further resources are warranted not only to meet anticipated new responsibilities, but to improve current oversight of an industry which has expanded in complexity and volume at a pace far exceeding the SEC's growth.

As a result, the bill would authorize the following additional amounts over the SEC request for fiscal years 1988-1989:

	Fiscal year—		
	1988	1989	1990
SEC request	\$153,900,000	\$169,000,000	\$181,100,000
Subcommittee request	158,600,000	172,200,000	N/A

The increases over the requested authorization levels for 1988 and 1989 represent a restoration to the SEC of budget cuts made by the Office of Management and Budget ("OMB") from the Commission's earlier mandatory budget submissions to OMB. In view of the history of virtually no resource growth at the Commission since 1980, the Subcommittee has determined that the resources originally requested by the SEC are justifiable to meet the agency's responsibilities in the current regulatory environment.

Moreover, this level of funding is further justified by the fact that the SEC will likely generate fee revenue substantially in excess of its budget during this period. These excess revenues generated from fees are a result of the high level of market activity; this excess revenue is itself a compelling argument supporting increases in Commission resources to meet the apparent underlying increases in regulatory demands. In conjunction with reaching this determination of appropriate authorization levels for the Commission, the Subcommittee specifically requests that, in the future, the SEC provide simultaneous copies to the Subcommittee of all Commission budget requests as submitted to OMB. Given the SEC's status as an independent regulatory agency, such material is necessary as part of the Subcommittee's oversight of the agency.

The authorized budget levels in the bill for 1988 and 1989 are additionally buttressed by testimony from industry witnesses before the Subcommittee in the February 1987 hearings. An industry witness, *Alvin v. Shoemaker*, Chairman of the Board, First Boston Corporation, testified that he would support a 100 percent increase in the current Commission budget. (Statement of *Alvin v. Shoemaker*, Chairman of the Board, First Boston Corporation, before the Subcommittee on Securities of the Committee on Banking, Housing, and Urban Affairs, United States Senate, February 24, 1987, page 9.)

Former SEC general counsel Harvey Pitt said,

There can be little doubt that the Commission lacks both the resources and the remedies that are necessary if the

agency is to deter securities law violations in the most efficacious manner. Saddled by budgetary constraints and a six-year policy of enforced silence about those constraints, the Commission is in danger of falling behind in the effort to police our securities markets.

(Written Statement of Harvey L. Pitt before the Securities Subcommittee of the Senate Banking, Housing, and Urban Affairs Committee, Regarding the Securities and Exchange Commission, February 24, 1987, page 17.) Mr. Pitt deemed the current level of SEC broker-dealer and investment adviser inspections to be "decidedly inadequate" and he also pointed out that in 1975 the SEC disclosure staff reviewed every annual report and proxy statement filed with the Commission, while in 1988 they plan to review less than 20 percent of these documents. (Pitt Statement, February 24, 1987, pages 10 and 12.)

Former SEC Commissioner James C. Treadway, Jr., in calling for a minimum budget increase of 50 percent to 75 percent, expressed his concern to the Committee that the SEC may have been outpaced by the markets based on his review of the number of enforcement actions taken, the relatively low level of disclosure review, and the limited automation initiatives in place. (Written Statement of James C. Treadway, Jr. Before the Subcommittee on Securities of the Senate Committee on Banking, Housing, and Urban Affairs, February 24, 1987.)

Following several years of minimal increases, the Commission's 1988 budget request represents about a 30 percent increase over the 1987 appropriation, providing for about an 8 percent in authorized staff positions primarily benefiting the Full Disclosure and the Suppression and Prevention of Fraud programs. The overall Full Disclosure program would receive an additional 59 authorized positions, divided mostly between the electronic filing program (Edgar) and the Division of Corporation Finance, for about a 15 percent increase. The anti-fraud program would gain an additional 73 positions, divided between the Enforcement Division and the Regional Offices, for an overall increase of about 11 percent. While the Subcommittee agrees with the need for these increases, it is concerned that only small increases or no staffing changes at all are planned for the staffs in the Market Regulation and Investment Management programs. The enormous increases in market activity, the need for greater oversight of self-regulatory organizations, and the rapid changes in products and trading techniques warrant greater growth in program resources for Market Regulation. Likewise, the massive growth in size and significance of the investment company and investment adviser industries supports enhanced oversight resources for Investment Management. The authorized level will allow for justifiable increases in these and other programs.

The balance of the increase requested by the SEC for 1988 is largely planned for non-personnel expenses associated with the Edgar system and replacing the Commission's main-frame computer. Concerning automation efforts by the Commission, in his testimony before the Subcommittee last February, former SEC Commissioner James Treadway particularly noted the need for immediate improvements in basic office automation at the Commission as well

as the need for more attention to the development of automated surveillance systems. Another witnesses at the February 24 hearing, Donald B. Marron, Chairman and Chief Executive Officer of Paine Webber Group, Inc., also advised the Subcommittee that, "The Commission should also develop a vastly improved surveillance capability for all U.S. securities markets." (Statement of Donald B. Marron Before the Subcommittee on Securities, Senate Committee on Banking, Housing, and Urban Affairs, February 24, 1987, page 10.) The authorized budget level in the bill should provide additional resources for the Commission to direct increased emphasis on developing automated surveillance systems and in addressing other automation needs beyond the Edgar project.

The Subcommittee believes that the levels authorized in the bill are reasonable and necessary to permit the efficient operation of the SEC during 1988 and 1989.

NEED FOR IMPROVED BUDGET PROCESS

The Subcommittee is requesting the following changes in the budget process in order to improve oversight: (1) As already noted, the SEC should simultaneously provide the Subcommittee with all budget materials provided to OMB; (2) Future submissions should include specific program goals, justification of the goals, and a description of the Commission's expectations for meeting the goals at the requested level of funding; and, (3) More complete information on the activities of self-regulatory organizations ("SROs"), including staffing levels, volume of investigations and enforcement actions, and specific new initiatives undertaken by these organizations to meet the increasing responsibilities shifted from the Commission.

Program Goals

At the Subcommittee's May 13 hearing on this authorization, GAO Assistant Comptroller General William Anderson testified that the SEC had in some previous years submitted budget requests which included program goals for the coming years, the justification and rationale for these goals, and the extent to which the Commission expected the goals would be reached within the constraints of the requested budget level. Mr. Anderson noted that, in his opinion, this provided a very useful oversight mechanism for the Subcommittee since it clearly indicated the Commission's priorities and expectations. (Statement of William J. Anderson, Assistant Comptroller General, General Government Programs, Before the Subcommittee on Securities, Senate Committee on Banking Housing, and Urban Affairs, May 13, 1987, page 5.)

As a result, the Subcommittee is specifically requesting that the SEC include the following items in its future budget submissions:

- A clear statement of program goals for each year during the requested budget period;
- justification and rationale for adopting the final program goals, including alternatives considered and the reasons for not adopting possible alternative goals; and

—the best estimation by the Commission of the extent to which it anticipates that the adopted goals will be reached with the level of funding requested for the programs.

In connection with these efforts to develop goals and corresponding measures of accomplishment, the Subcommittee notes current interpretive variations between program results reported from some measuring systems now in place at the SEC and results of the same programs as interpreted by knowledgeable people outside of the Commission.

While the Subcommittee recognizes the difficulties in developing accurate and useful workload reporting systems, it believes that the Commission can improve on its systems for reporting productivity and projecting workload goals. Future budget documents should present more meaningful data and conclusions regarding the Commission's accomplishments and plans.

Information on the Activities of Self-Regulatory Organizations

The Commission's budget austerity actions of the past few years have resulted in more reliance on the SROs to oversee the operations of market participants. The Subcommittee, in expressing increasing concern over the proper role of SROs in the regulatory process, notes the opinion written last month by securities attorney and former SEC commissioner Bevis Longstreth that,

The Commission's recent policy of delegating customer complaints to the SROs has resulted in less than the optimal level of vigilant investigation and enforcement of the duty to supervise by the Commission staff itself, and this factor was, in my judgment, a contributing cause in the recent Wall Street scandals.

While the Subcommittee is supportive of the SRO concept, more information is needed on SRO resources and operations in order for the Subcommittee to exercise oversight of the SEC's activities. Assistant Comptroller General Anderson testified regarding the role of SRO information in the budget process at the May hearing:

There are two issues here. First, we are not certain about the level of market oversight the SROs can effectively provide, given their own resource constraints and other inherent limitations. Second, we believe the Congress needs better information to gauge the appropriate level of direct federal oversight that should be provided in order to better determine the Commission's resource needs.

(Anderson Statement, May 13, 1987, pages 6-7.)

The Subcommittee's concern for more complete information on SRO activities is heightened by the repeated assurances in the SEC's 1988 budget request that the increased demands on the Commission are being met by increased delegations to the SROs in a number of areas where little or no additional resources are to be added at the SEC. It has become apparent that the role of SROs in meeting the SEC's oversight responsibilities has become so critical as to require that the Subcommittee routinely receive more complete information on SRO activities as a part of the budget process.

Accordingly, the Subcommittee requests that the Commission provide the following information on SRO activities with the next budget submission:

- Each SRO's annual operating budget, staffing level, and turn-over rates;
- each SRO's activity in terms of annual inspections or examinations, total investigations initiated (including the subject areas of such investigations and the dispositions thereof), and total enforcement actions initiated;
- the frequency of comprehensive SEC inspections of the SRO's enforcement and surveillance activities;
- the need for expanded powers to enable the SRO's to better carry out supervisory and enforcement responsibilities;
- a report on insider trading investigations initiated by the SRO's during the period 1983 through 1986, including the number of referrals to the SEC and the number or proceedings instituted by each SRO for insider trading violations;
- the number of SRO enforcement proceedings instituted against firms for failure to supervise employees by member organizations;
- SRO and member firm initiatives with respect to ongoing problems such as employee trading abuses and the existence of firm policies and procedures concerning proprietary trading including so-called risk arbitrage activities;
- a description, including the planned budgets and staffing, of all new initiatives and programs undertaken by the individual SROs to meet new responsibilities shifted to these organizations by the SEC;
- a summary of any inconsistencies occurring in regulatory treatment including investigatory proceedings or with respect to severity of disciplinary sanctions or other lack of coordination between different SROs; and
- information on the SEC resources allocated to oversight of SROs.

Given the SEC's portrayal of the critical and increasing role of the SROs in the Commission's execution of its regulatory responsibilities, it seems reasonable to assume that the SEC is already accumulating this type of data in the course of its SRO oversight activities and that this request will, accordingly, not impose a significant additional burden on the Commission. It is apparent that this information will provide the Subcommittee with a clearer picture of the level of regulatory oversight occurring in the securities markets.

ADDITIONAL SUBCOMMITTEE CONCERNS

Investment Management Program

The Subcommittee has noted the enormous growth in the number of investment companies and investment advisers registered with the SEC. Particularly in the absence of an SRO for this industry, the strain this growth is placing on the Commission is apparent. The significance of this industry has been compounded by the amount of assets under its control with a parallel increase in the importance of adequate regulatory oversight. The Subcommit-

tee encourages the SEC's efforts to assess the problem of providing industry oversight and expects that the Commission will soon propose appropriate responses.

In the interim period until suitable regulatory alternatives can be developed with the states and/or self regulatory organizations, the Subcommittee is concerned that the SEC ensures that adequate resources are dedicated to oversight of this industry. The investment management industry has rapidly accumulated assets sufficient to categorize it as a financial intermediary in the same league with banks, thrifts, and life insurance companies. The level of staffing and other resources for this program have been conspicuously static relative to the enormous growth in the size and significance of the industry. Particularly at this time of rapid growth in the regulated investment management industry, the SEC should not allow a lapse in regulatory oversight to occur while searching for vehicles to share the burden of regulatory responsibility.

Enforcement Activities

The Subcommittee commends the enforcement program for its success in recent cases involving major securities law violations. It is important to the Subcommittee that the SEC plan for and provide adequate resources as necessary to aggressively pursue all investigations to their ultimate conclusion.

Based on recent developments, the increase planned for the Enforcement Division is clearly warranted. The Subcommittee is concerned that the increase may not be sufficient to deal with ongoing abuses uncovered in various aspects of its enforcement program. The Subcommittee is also concerned that the recent surge in insider trading cases does not adversely impact enforcement resources available to other significant enforcement programs, such as assuring full and complete disclosure in SEC filings. As discussed below, the Subcommittee also stresses the need to plan for resources necessary for enforcement activity related to the increasing internationalization of the securities markets. In particular, the Subcommittee wishes to assure that the SEC has adequate resources to enable the Enforcement Division to fully litigate its various enforcement actions in court.

Finally, the surge in well-publicized instances of fraudulent activities by persons associated with savings and loans and other financial institutions raises serious questions. An enhanced governmental enforcement presence is clearly warranted. The Subcommittee requests that the SEC, in coordination with the various interested bank regulatory agencies, promptly address this serious issue.

Edgar

The SEC's electronic filing project, Edgar (electronic data gathering, analysis, and retrieval,) has been designed as an attempt to automate the filing, processing, and dissemination of the Commission's over nine million pages of filings. Ideally, it will improve the speed and effectiveness of SEC processing and supply more rapid and timely dissemination of corporate and financial information to investors and the financial community. The Commission is working

toward the goal of using Edgar to accept electronic filings and make the information accessible to investors, the media and others in a matter of minutes rather than days and weeks. Eventually, the system should be accessible from personal and business computers. Under the phasing-in planned for constructing Edgar, 1988 will be a pivotal year in moving from a test system to an operational system. During 1988, Edgar is scheduled to reach nearly 4,000 publicly-held companies filing 30,000 documents annually. The largest single year expenditure on the system is planned for 1988 with a \$20 million allocation for payments to the Edgar operational contractor. As such, the benefits promised by the Commission from Edgar should begin to become evident during the year and into 1989.

The Subcommittee supports the concept of electronic filing as envisioned in the Edgar project. It believes that both the Commission and the private sector can benefit from Edgar's full implementation.

The Subcommittee is aware of issues that have been raised about the Edgar operational contract and the potential implications for Edgar's full implementation. The Subcommittee notes these concerns and will continue to monitor the development of the Edgar system. This authorization bill does not modify the requested Edgar funding levels.

Corporate Filings in the Full Disclosure Program

As noted, former SEC Commissioner Treadway and former SEC general counsel Pitt expressed alarm to the Subcommittee at the February hearing over the significantly declining percentage of filings which are subjected to review by the Commission. The Subcommittee is concerned that sufficient resources be provided to maintain a level of review adequate to promote compliance with the disclosure requirements of the securities laws. The number of enforcement cases resulting from filings identified as deficient and the number of deficiency letters to registrants that result from those reviews indicate that the pay-off from filing review is high. The Subcommittee stresses the need to provide the full disclosure program with adequate reviewing resources. The aggressive functioning of the comment and review process requires the commitment and direction of the Division of Corporation Finance's most senior personnel.

In addition under this program, the Subcommittee is concerned about the increasing backlog of unprocessed filings as reported in a GAO report (GAO/GDD-86-87FS, July 10, 1986). The Commission needs to provide sufficient resources to greatly reduce this backlog and to keep it from recurring.

Specifically, the GAO report stated that the Commission, because of its growing workload of filings to be reviewed, has assigned a low priority to certain filings and not processed them. The inventory of unprocessed, low priority filings—primarily the 10-K's and 100's—increased 166 to 700 percent respectively between 1983 and the first six months of 1986. Although the Commission is taking action to identify the number of companies reviewed, rather than the number of filings, the GAO has advised that the program could still benefit from a system which ascertains how often and to what

extent companies should be reviewed and measures the results of the reviews in terms of deficiency letters, enforcement actions, or other outcomes which provide a reflection of the level of accuracy in overall reporting.

Clearly the benefits of reviewing every filing become marginal at some point, but the SEC must assure the Subcommittee that it is adequately reviewing the filings so as to achieve the fullest possible disclosure. As discussed above concerning improvements to the budget process, as part of the next budget estimate submission the Commission should determine an appropriate goal for filing reviews and explain the rationale for the level adopted. The SEC should note the number of referrals from the Division of Corporation Finance that resulted in the institution of enforcement actions and the number of Form 10K Annual Reports which were the subject of full review should be indicated.

The Commission should also include a description in its next budget submission of the results of the Edgar program in facilitating better management of the full disclosure program.

Internationalization

Foreign securities have become important investment vehicles for U.S. investors, and raising capital abroad has become significant to U.S. companies. U.S. issuers raised a record \$43.7 billion through international bond issues in 1986 while foreign issuers borrowed \$6.1 billion in the U.S. bond market during the same year. On the equity side, U.S. investors purchased and sold \$101.2 billion in foreign stock in 1986 while foreign investors' activity in U.S. corporate equity securities reached \$277.3 billion.

The Subcommittee shortly expects to receive a report by the Commission on the internationalization of the securities markets requested both by the Subcommittee and by the House Committee on Energy and Commerce. The report is expected to cover a wide range of topics, including the scope of internationalization, multinational registration and disclosure issues, the functioning and regulation of international secondary markets and market professionals, the participation of investment companies in international markets, and the enforcement of the U.S. securities laws in an era of internationalization. The Commission completed its interim progress report in October 1986, hosted a related roundtable of experts on many different aspects of internationalization on February 17, 1987, and expects to submit a final report to Congress this summer.

The Commission has taken a number of other actions involving internationalization. The Commission has approved the establishment of linkages between U.S. and foreign markets, including trading linkages between the Boston Stock Exchange and the Montreal Exchange, between the American and Toronto Stock Exchanges, and between the Toronto and Midwest Stock Exchanges. The Commission has also temporarily approved a quotation sharing program between the National Association of Securities Dealers and the International Stock Exchange (formerly, the London Stock Exchange). To ameliorate the problems surrounding international clearance and settlement, the Commission's staff has issued no-action letters to foreign clearing agencies wishing to establish auto-

mated securities processing links with their U.S. counterparts. The Commission is also considering the facilitation of multinational securities offerings through adopting reciprocal prospectus requirements with certain other countries.

In the enforcement area, the Commission has required that linked foreign and domestic markets, acting as self-regulatory organizations, develop surveillance and information-sharing agreements and has pursued bilateral and multilateral mechanisms for obtaining information to carry out its enforcement responsibilities. In particular, the Commission has taken the initiative in negotiating international agreements providing for cooperation and information-sharing with Swiss, Japanese, Canadian and U.K. authorities. Other such agreements are contemplated by the Commission.

A clear example of the benefits that can be obtained by international cooperation in the enforcement area was the Commission's insider trading case against Dennis Levine. In this case, the Commission was able to identify Levine through documents made available from Bank Leu International, a financial institution located in the Bahamas, with the cooperation of the Bahamas Attorney General. As a result of the Commission's efforts, Levine consented to an administrative sanction and a permanent injunction and agreed to disgorge \$11.6 million in illegal trading profits. He pleaded guilty to criminal charges of securities fraud, tax evasion, and perjury and is presently serving a two-year sentence. His agreement to cooperate with the government has led to other major insider trading cases, including the Ivan Boesky settlement.

The Commission is to be commended for its efforts in the internationalization area. The accelerating internationalization of the securities market is significantly changing the ways in which the securities markets function.

The Commission must continue to exercise an aggressive and leadership role in ensuring that the United States securities industry retains its competitiveness in the international capital markets. The Commission must ensure that regulatory and governmental actions affecting the securities industry are designed so as not to impede United States competitiveness in the global arena. The Subcommittee continues to be vitally interested in structuring a regulatory environment which at the same time preserves the integrity of our capital markets and enhances our competitive position. At the same time, the Subcommittee strongly emphasizes that the full and fair disclosure of the U.S. securities markets must be observed. The internationalization of the capital markets remains a paramount issue among the Subcommittee's priorities and must also be a high priority of the Commission.

Economic and Policy Analysis

At the February 24, 1987 hearing, Milton H. Cohen, a distinguished securities attorney and principal author of the 1963 Special Study of the Securities Markets, testified before the Subcommittee regarding his concerns over the quality of economic advice provided to the Commission and the present role of economists in its policy making. Mr. Cohen noted that the current staff economists "primarily rely on econometric approaches based on quantitative data, rather than on broader analytic approaches using non-quantitative data."

fiable data," and that their uniform philosophy in providing economic advice is to rely on the market as the best regulator. (Statement of Milton H. Cohen before the Securities Subcommittee of the Committee on Banking, Housing, and Urban Affairs of the United States Senate, February 24, 1987, pages 5 and 6.)

In recent years, the Commission has published a number of econometric studies prepared by its staff dealing with various aspects of our capital markets and Federal and State regulation of those markets. Because of the Commission's status, those studies have had a significant impact on public perceptions of those markets and their regulation. In addition, it appears that the Commission has relied on those studies to an increasing degree as determinants of policy direction and regulatory outcomes in carrying out its responsibilities under the federal securities laws.

Economic analysis is a useful regulatory tool—but one with inherent dangers and limitations. The Subcommittee is concerned that, first, the Commission does not have in place procedures that assure the integrity and soundness of its staff's economic studies, and that, second, the Commission may have allowed the limitations inherent in an econometric approach to regulatory matters to erode its willingness to use the authority conferred by the federal securities laws to address problems that are not amenable to econometric measurement.

The Subcommittee believes that economic studies prepared by the Commission's staff should be subjected to at least the same degree of discipline that is imposed on studies authored by other economists before publication—i.e., to peer review as to methodology and content by independent economists of high professional standing. Indeed, given the importance that economic studies authorized by the Commission's staff have assumed, the Subcommittee believes that the Commission should do more than that by adopting procedures that will ensure participation by the public in the design and evaluation of those studies, all in a manner analogous to the notice and comment process contemplated by the Administrative Procedure Act for agency rulemaking proceedings.

In particular, the Subcommittee believes that the Commission should begin providing advance public notice of its staff's intention to undertake economic studies relating to particular Commission policies or regulatory issues and should solicit public comment on their design before they proceed. Such notices should describe in detail, and should encourage interested persons to comment on, such matters as the relevance of the study to the policy or issue being examined, the reliability and completeness of the data to be examined, and the appropriateness of the analytical techniques to be employed. Summaries of all comments received and a discussion of the points raised by commentators (especially concerning scope and methodology) should be included in each staff economic study published by the Commission.

Finally, the Subcommittee believes that all raw data examined by the Commission's staff in connection with studies conducted for regulatory purposes should be made available to the public as a matter of general practice. (In some cases, of course, it may be necessary to strip from such data material identifying the particular person or entity from whom the data was received or whose activi-

ties are reflected in the data.) Availability of this information—without the need to invoke the provisions of the Freedom of Information Act to obtain it—should encourage interested persons to subject the staff's data to further analysis and, in appropriate cases, to provide additional comments to the Commission concerning the policy or regulatory issue examined.

The Subcommittee believes that adherence to procedures of the kind outlined above would increase public confidence in staff economic studies published by the Commission, would enable the Commission to better evaluate the weight that should be given to such studies in formulating policy or resolving particular regulatory issues, and would help assure that such studies are conducted in the manner best calculated to produce meaningful and reliable results.

The Subcommittee does not intend that any of the additional funds authorized by the bill beyond the SEC request should be allocated to the operations of Economic and Policy Analysis. Absent significant movement by the Commission, as described above, in the management and operation of functions currently executed by Economic and Policy Analysis, the Subcommittee will consider specifically declining to authorize any funds for the operations of this program in the next budget authorization.

SEC Self-Funding Report

As noted above, the SEC is, in effect, as self-funding agency through the fees which it is authorized to assess on its users. With the recent massive growth in the securities markets and the minimal growth in SEC resources, the revenue generated by the Commission has, in recent years, exceeded its budget by more than 100 percent. This excess revenue does not even include fines and penalties collected by the Commission. Under present law, all fees, fines, and penalties levied by the Commission are paid to the Treasury and the agency is funded through the appropriations process. As such, the SEC is subject to all applicable Federal government employment limitations, contracting, leasing and other provisions which control the spending activities of appropriated agencies.

At the Subcommittee's May 13 hearing on this authorization, SEC Chairman John Shad testified concerning the slow resource growth at the Commission that:

Some of our authorized positions simply can't be filled simply because we are not competitive on salaries, on compensation—accountants, lawyers, security analysts are in great demand. During this enormous bull market, the law firms, the security firms—I wouldn't say are raiding the SEC, but a huge portion of our staff turnover annually is they leave the government to dramatically increase their compensation by going with the leading law, accounting and securities firms. In fact, we are constantly losing good people to the private sector.

(Transcript of Proceedings, Committee on Banking, Housing and Urban Affairs, Subcommittee on Securities, Oversight Hearing on SEC Authorization, May 13, 1987, page 27.)

In addition, at the Subcommittee's February 24, 1987 hearing, former SEC general counsel Harvey Pitt indicated that his first legislative recommendation to the Subcommittee was:

The Commission's budgetary and manpower constraints should be alleviated by permitting the agency to fund its operations from the private sector, and to pay its employees a competitive salary, above the current Civil-Service scale. Filing and other fees, and perhaps even penalties under the Insider Trading Sanctions Act (assuming that conflict-of-interest concerns can be overcome), should be utilized to fund the Commission's operations.

(Pitt Statement, February 24, 1987, page 21.)

Former SEC Commissioner James Treadway also strongly endorsed a legislative change to permit the Commission to be directly self-funding at the February hearing.

As a result, the Subcommittee requests the Commission to prepare a study regarding the transformation of the SEC from an appropriated agency to a self-funding agency outside of the usual constraints on appropriated agency fiscal operations. The study should include at a minimum:

- recommendations of the Commission on this proposal;
- specific legislative language necessary to effect any recommended changes;
- projections as to the changes any recommendations might generate in staff turnover, productivity, and effectiveness;
- ramifications of a change in revenues under any recommendations; and
- how to maintain adequate Congressional oversight outside of the appropriations process.

The Subcommittee requests that this proposal be completed by November 30, 1988.

SUMMARY

The Subcommittee is satisfied that the original level of funding requested by the SEC for 1988 and 1989 prior to cuts made by the Office of Management and Budget is justifiable given the Commission's history of restrained growth and the current regulatory environment. The additional resources authorized by the bill should, in particular, provide increases to programs which had not been designated for adequate growth in 1988 including enforcement activities and SRO oversight by the Division of Market Regulation. The Subcommittee is also concerned that adequate resources be devoted to automation initiatives, such as improved market surveillance, other than the Edgar project.

In addition, the Subcommittee has requested specific improvements in the budget process to be implemented with the next budget submission. These improvements include simultaneous submission to the Subcommittee of OMB budget submissions; identification by the SEC of meaningful goals and priorities; and, more complete information on the activities of industry self-regulatory organizations.

The Subcommittee had highlighted critically needed improvements in the operations of the SEC's Economic and Policy Analysis

Division and stressed the need for a commitment to the issues related to the internationalization of the securities markets.

Finally, based on the Commission's effective self-funding status and the recommendations of a number of witnesses, the Subcommittee is requesting that the SEC prepare a report with recommendations regarding alternatives to the appropriations process for the Commission's funding and operations.

TECHNICAL AMENDMENTS

The Commission requested the provisions of the bill making technical, clarifying, and conforming amendments to the securities laws. The bill also clarifies the enforcement capabilities of the Commission and the other Federal regulatory agencies for transfer agents.

These technical amendments were originally requested in 1983 by Senator Timothy E. Wirth when he was Chairman of the House Subcommittee on Telecommunications, Consumer Protection, and Finance. The first version of these technical amendments was introduced in the 98th Congress as H.R. 4574, sponsored by Chairman Wirth and Chairman John D. Dingell of the House Committee on Energy and Commerce. The technical amendments were again introduced in the 99th Congress by Chairman Wirth as H.R. 1604 and by Senator D'Amato as S. 920.

The technical amendments in the bill were specifically requested by SEC Chairman John Shad in his appearance before the Subcommittee for the Commission's authorization hearing on May 13, 1987.

SECTION-BY-SECTION ANALYSIS OF THE TECHNICAL AMENDMENTS

TITLE I

Title I of the Bill would effect various amendments of the Securities Act of 1933 (the "1933 Act").

Section 101 would change the definition of the term "Commission" in section 2(5) of the 1933 Act so that it refers to the Securities and Exchange Commission rather than the Federal Trade Commission. The FTC administered in the 1933 Act before the establishment of the SEC in 1934.

Section 102 would amend the definition of "Territory" in section 2(6) of the 1933 Act to exclude the Canal Zone. Pursuant to the Panama Canal Treaty between the United States and Panama, T.I.A.S. No. 10,030 (Sept. 7, 1977), the Canal Zone is no longer a possession of the United States. *Sections 202, 502, and 601* would exclude the Canal Zone from the definition of "State" under the Securities Exchange Act, the Investment Company Act, and the Investment Advisers Act, respectively, and *Section 508(1)* would exclude the Canal Zone from a list of United States possessions, for the same reason.

Section 103 would repeal as obsolete Section 3(a)(1) of the 1933 Act. Section 3(a)(1) provided an exemption from the registration provisions of the Act for offerings pending at the time the Act's enactment and, in the words of a leading commentator, "has long since spent its force." L. Loss, *Fundamentals of Securities Regula-*

tion 297 (1983). The bill would reserve the paragraph (1) designation for future use, rather than renumber the remaining paragraphs. These paragraphs have been in effect for over 50 years, and are among the most frequently cited provisions of the securities laws. Renumbering them would cause unnecessary confusion and result in undue expense in, for example, the extensive editing of reference works that would be required.

Section 104 would amend the registration exemption in section 3(a)(5)(A) of the 1933 Act for securities issued by regulated savings and loan associations and similar institutions by eliminating the so-called "3 percent limitation." The 3 percent limitation makes the S&L exemption inapplicable if the issuer of the security takes a fee from the purchaser in excess of 3 percent of the face value of the security.

The reason for including the 3 percent limitation in the S&L exemption is unclear. The legislative history of the 1933 Act is silent on the subject, and the Commission had rarely attempted to deny the availability of the exemption on the basis of the limitation. The only apparent recorded instance of a denial occurred in 1935, when the Commission staff indicated in a letter that the exemption would be unavailable if an S&L deducted a withdrawal fee in excess of 3 percent from the account of an investor, even if the deduction were made solely from profits previously credited to the investor's shares.

The 3 percent limitation appears to have little or no application to the securities of S&L's in today's marketplace. Moreover, it could be considered a form of discrimination against S&L's, as compared to banks, since banks are not subject to any similar restriction in the exemption provided for their securities under section 3(a)(2) of the 1933 Act.

Section 105 would delete section 6(e) of the 1933 Act as obsolete. Section 6(e) provides that no registration statement may be filed within the first 40 days following the Act's original enactment, which occurred on May 27, 1933.

Section 106 would make conforming changes to section 9 of the 1933 Act necessitated by other enactments. *Section 106(1)* would conform the nomenclature for federal appellate courts of general jurisdiction in section 9(a) of the 1933 Act from "Circuit Courts of Appeals" to "courts of appeals," to conform to the nomenclature adopted in 1948. *Section 106(2)* would conform the name of the United States Court of Appeals for the Districts of Columbia to the name change adopted in 1934. *Section 106(3)* would replace a reference to sections 239 and 240 of the Judicial Code with a reference to 28 U.S.C. 1254, where the provisions of sections 239 and 240 of the Judicial Code were codified when title 28 was enacted into law in 1948. *Sections 303 and 606* would make the same change in Section 24 of the Public Utility Holding Company Act of 1935 and section 213(a) of the Investment Advisers Act of 1940, respectively.

Section 107 would amend section 19(c) of the 1933 Act to facilitate cooperation by the Commission with state regulators and industry groups in resolving small business capital formation problems. Such cooperation was mandated by title V of Small Business Investment Incentive Act of 1980, Publ. L. No. 96-477, 94 Stat. 2275 (primarily codified at 15 U.S.C. 80a-53-64) ("Incentive Act").

Title V calls for two annual conferences at which federal and state securities authorities meet with one another, and with the investment community and small business organizations, for the purpose of resolving problems of small business capital formation and coordination of federal and state securities laws in general. The first conference, required under section 503 of the Incentive Act (15 U.S.C. 80c-1), is an annual government/business forum to review the status of problems and programs relating to small business capital formation. The Commission is required to invite to participate in the forum other federal agencies, organizations representing state securities commissioners, and leading small business and professional organizations concerned with capital formation.

The second conference, required under section 19(c) of the 1933 Act (as added by section 505 of the Incentive Act), is an annual conference to promote cooperation among federal and state securities authorities. Section 19(c) requires the Commission to invite participation in this conference by representatives of associations of state securities officials and other duly constituted securities associations, securities self-regulatory organizations, agencies, and private organizations involved in capital formation. Section 19(c) also directs the Commission to conduct necessary meetings with these representatives to carry out the policies and purposes of Congress reflected in section 19(c). Finally, title V authorizes the Commission to cooperate and share information with associations of state securities officials to effectuate greater uniformity among the Federal Government and the states in securities regulation matters.

Since the decision of the United States Court of Appeals for the District of Columbia Circuit in *Center for Auto Safety v. Cox*, 580 F.2d 689 (1978), there has been some question as to whether federal statutes requiring standards and uniform procedures governing the establishment, operation, and duration of advisory committees, task forces, and similar groups apply to cooperative efforts like those required of the Commission by title V. The court in *Center for Auto Safety* held that some provisions of the Federal Advisory Committee Act ("FACA") applied when the Administrator of the Federal Highway Administration used the American Association of State Highway and Transportation Officials to obtain advice and recommendations in developing regulations, which were exempt from the notice and comment requirements of the Administrative Procedure Act, to govern the federal-aid highway program. The court did not determine which specific provisions of the FACA applied when the Administrator used this association of state officials in developing the regulations.¹ The FACA includes numerous provisions that could apply, including provisions requiring federally-approved charters, balanced membership, open meetings chaired by a federal official, review by the Office of Management and Budget and automatic termination of groups unless extended.

The Commission believes that it was not Congress' intent in enacting the Incentive Act that these kinds of provisions should apply to the cooperative efforts mandated by title V of that Act. It would be difficult, if not impossible, to implement several of the FACA's

¹ The court remanded the case to the district court for such a determination. The district court's determination on this issue is not reported.

requirements in the context of the meetings and communications required by title V. For example, under the FACA legislation, agencies establishing advisory committees should "require the membership * * * to be fairly balanced in terms of the points of view represented and the functions to be performed by the advisory committee." Congress clearly had no such balance requirement in mind when it passed title V. It is of the nature of the meetings and consultations contemplated by title V that the composition of the groups formed to discuss various issues will change radically depending on the issue and the nature of the discussions. It would be impossible to carry out the congressional mandate with one—or even several—"committees" with fixed membership and a defined charter. Applying these and other provisions of the FACA would substantially impede the cooperation that currently exists between the Commission and state securities authorities in the area of promoting small business capital formation and would hamper efforts to improve such cooperation. It would be particularly inappropriate to apply the FACA to the Commission's work with pre-existing organizations like the North American Securities Administrators Association, with which the Commission has been working closely under title V.

Thus, *Section 107* merely would clarify what the Commission believes to have been Congress' original intent. The Administrative Procedure Act and the securities laws contain safeguards sufficient to prevent the kinds of abuses that concerned the court in *Center for Auto Safety*. The Commission would have to adopt any proposed regulations resulting from title V consultations pursuant to the notice and comment procedures of the Administrative Procedure Act, and in compliance with additional standards set forth in the securities laws.

Sections 108 and 109 would delete references in sections 20 and 22(a) of the 1933 Act to the District Court of the United States for the District of Columbia. These references are superfluous in view of 28 U.S.C. 132(a), which states that "[t]here shall be in each judicial district a district court which shall be a court of record known as the United States District Court for the district," and 28 U.S.C. 88, which states that "[t]he District of Columbia constitutes one judicial district." *Section 108* would also make minor, nonsubstantive stylistic changes to section 20(b) and (c). *Section 109(3)* would amend section 22(a) by replacing a reference to sections 128 and 240 of the Judicial Code with a reference to sections 1254, 1291, 1292, and 1294 of title 28, where the provisions of sections 128 and 240 of the Judicial Code were codified when title 28 was enacted into law in 1948. *Sections 223(2), 226, 302(2), 303, 304, 606, and 607* would delete references to the United States District Court for the District of Columbia and replace references to the Judicial Code with references to title 28 in the Securities Exchange Act, the Public Utility Holding Company Act, and the Investment Advisers Act for the same reasons.

TITLE II

Title 2 of the Bill would effect various amendments of the Securities Exchange Act of 1934 (the "1934 Act").

Section 201 would replace a reference to section 11(k) of the Federal Reserve Act in section 3(a)(6)(C) of the 1934 Act with a reference to the Comptroller of the Currency. Public Law No. 87-722, which was enacted in 1962, repealed section 11(k) of the Federal Reserve Act and transferred the authority exercised under that subsection to the Comptroller of the Currency pursuant to 12 U.S.C. 92a.

Section 202. See discussion of *Section 102*, above.

Section 203 would remove the ambiguity in the definition of "exclusive processor" in section 3(a)(22)(B) of the 1934 Act that resulted from the omission of two commas, an apparent typographical error.

Section 204 would capitalize the word "state" in section 3(a)(34)(C) of the 1934 Act and thereby remove any ambiguity as to whether it refers to the defined term "State" used elsewhere in the Act.

Section 205 would correct two apparent typographical errors in section 3(a)(39)(B) of the 1934 Act. The first correction involves inserting a conjunction in a series of items where there is none now. The second involves including within the definition of "statutory disqualification" for purposes of the Act "suspension" for a period not exceeding twelve months" from being associated with a broker, dealer, municipal securities dealer, government securities broker, or government securities dealer. This would conform the definition of "statutory disqualification" to the statutory sanctioning authority of the Commission in section 15(b)(6) of the 1934 Act. It is apparent that the omission is a typographical error both because the language does not conform to section 15(b)(6) and because suspension by a self-regulatory organization from being associated with a member of the organization, which would generally be a lesser sanction than suspension by the Commission for a period not exceeding twelve months from being associated with a broker or dealer, is included within definition of "statutory disqualification" under section 3(a)(39)(A).

Sections 206 and 223(3) would transfer the definition of the term "securities laws," which now appears in section 21(g) of the 1934 Act, to section 3(a), the "definitions" section of the Act. The transfer is advisable because the term is used in new section 4(e), which would be added by *Section 207*. *Section 206* also would conform the language of the definition to the style of section 3(a) and correct several obviously erroneous cross-references in the definition.

Section 206 also would add a definition of the term "person associated with a transfer agent" to section 3(a). The new definition is necessary because of the new authority over such persons conferred under *Section 222*. The definition is patterned after the definition of the terms "person associated with a broker or dealer" and "person associated with a municipal securities dealer" in sections 3(a)(18) and 3(a)(32) of the 1934 Act, except that persons whose functions are solely clerical or ministerial are excluded from the new definition for all purposes. The definition also excludes employees of diversified transfer agents, such as banks, who are not involved in transfer agent functions.

Section 207 would add new subsection (e) to section 4 of the 1934 Act. Section 4(e) would give the Commission authority by rule to

decline to accept payment of fees in cash, and to prescribe the manner of such payments.

The receipt of cash by the Commission raises security and safe-keeping problems. The Commission's administration of the federal securities laws does not otherwise require it to handle, safeguard, and maintain records regarding large amounts of cash. The amount of individual and aggregate cash payments received on a particular day is sometimes quite large, occasionally several thousand dollars. The Commission now attempts to assure the safety of the cash it receives, and of the employees who receive it, by making special security arrangements. Special separate record-keeping and auditing procedures are also required because of the Commission's acceptance of cash. The Commission believes it could reduce costs if it were not required to accept cash payments for fees.

Section 208 would add new sections 4A and 4B to the 1934 Act. The additions would not make any substantive change in current law. The provisions that would be added as sections 4A and 4B are now contained in a 1962 statute, which is codified after section 4 of the 1934 Act in the United States Code, but is not a part of that Act. The provisions concern delegation of functions by the Commission and transfer of functions with respect to assignment of personnel to the Chairman. *Section 208* would insert these provisions into the 1934 Act, where they would be more readily accessible, and would make minor stylistic changes to conform the provisions to current legislative drafting conventions.

Section 209 would correct a typographical error in the first sentence of section 6(c)(2) of the 1934 Act. The words "of investors" were omitted after the word "protection." Inserting the words would logically complete an otherwise incomplete thought.

Section 210 would correct an obvious typographical error in section 6(c)(3)(A) of the 1934 Act. The phrase "any natural person association with such broker" is meaningless. By changing the word "association" to "associated," the phrase assumes the meaning intended by Congress.

Section 211 would amend section 6(c)(4) of the 1934 Act to correct a typographical transposition of the letter "(A)", which designates a clause within a sentence, and the verb in the sentence.

Section 212 would delete as obsolete paragraph (3) of section 6(e) of the 1934 Act. It also would provide for the redesignation of paragraph (4). Paragraph (3) provides for the filing by the Commission, until December 31, 1976, of certain information with Congress. The filings are not required after that date. *Section 212(3)* would correct an obvious typographical error by substituting the word "fixing" for the word "fixes" in subparagraph (E), so as to conform its use to other clauses in the subparagraph.

Section 213(1) would amend an obvious typographical error in section 11A(b)(2) of the 1934 Act. The word "transaction" should be in the plural so as to be in accord with the words "in securities" which immediately follow.

Section 213(2) would delete as obsolete two sentences in section 11A(c)(4) of the 1934 Act. The sentences required the Commission, by September 1975, to report to Congress on exchange rules limiting off-board trading and to commence, and to conclude before the

end of 1975, a proceeding amending any such rules that were unnecessary or inappropriate. These requirements were met several years ago.

Section 214 would delete sections 11A(e) and 12(m) of the 1934 Act. Section 11A(e) provides for a study and report concerning the extent to which persons excluded from the definitions of "broker" and "dealer" maintain accounts on behalf of public customers. The report was submitted in 1977. Section 12(m) provides for a study and report concerning the practice of recording ownership of securities in street and nominee names. The report was submitted in 1977.

Section 215 would correct an apparent typographical error in section 13(c) of the 1934 Act, where the word "of" appears between the words "thereof" and "the" in what is obviously intended to be the phrase "the Commission shall require in lieu thereof the submission."

Section 216 would delete section 13(h) of the 1934 Act. Subsection 13(h) provides for a study and report concerning the effectiveness of the ownership reporting requirements of section 13 and the desirability and feasibility of modifying the 5 percent threshold reporting requirement of section 13. The report was submitted in 1980.

Section 217 (1) and (2) would amend section 15(b)(4) of the 1934 Act to permit the Commission to bar or otherwise sanction a broker-dealer on the basis of a conviction arising out of the conduct of the business of a securities transfer agent or on the basis of an injunction prohibiting the broker-dealer from acting as a transfer agent. The amendment also would have the effect of permitting the Commission to sanction municipal securities dealers and associated persons of broker-dealers and municipal securities dealers for convictions or injunctions related to securities transfer agent activities, and of permitting the "appropriate regulatory agency"² for a municipal securities dealer to do likewise with respect to municipal securities dealers and their associated persons within the jurisdiction of the agency.³

At present, section 15(b)(4) permits the Commission and the appropriate regulatory agencies to sanction broker-dealers, municipal securities dealers, and their associated persons on the basis of convictions and injunctions relating to numerous financial activities, including banking, insurance, commodity futures, and most securities-related activities. There is no apparent reason for not authorizing sanctions for convictions and injunctions related to securities transfer agent activities.

The amendment is similar in concept to Congress' action in section 6(b) of the Insider Trading Sanctions Act of 1984, Pub. L. No. 98-376, § 6(b), 98 Stat. 1265 (Aug. 10, 1984), where convictions and

² Section 3(a)(34)(A) of the 1934 Act provides that either the Comptroller of the Currency, the Federal Reserve Board, or the Federal Deposit Insurance Corporation is the "appropriate regulatory agency" for a municipal securities dealer that is a bank, bank holding company, or department, division, or subsidiary thereof within the primary regulatory jurisdiction of the agency.

³ These effects would result because sections 15(b)(6), 15B(c)(2), and 15B(c)(5) of the 1934 Act, which authorize administrative sanctions against associated persons of broker-dealers and against municipal securities dealers and their associated persons, incorporate by reference most of the permissible bases for sanctions provided in section 15(b)(4).

injunctions related to commodity futures activities and violations of the Commodity Exchange Act were added to the list of permissible bases for administrative sanctions against broker-dealers, municipal securities dealers, and their associated persons. The amendment also would effect several stylistic changes to conform section 15(b)(4) to the administrative sanctioning provisions of the Investment advisers Act of 1940, which also would be amended by the bill to add convictions and injunctions related to transfer agent activities to its list of permissible bases for administrative sanctions. See discussion of *Sections 602 (1) and (2)*, below. Sections 9 (a) and (b) of the Investment Company Act of 1940 would be amended correspondingly to add convictions and injunctions related to transfer agent activities to their lists of bases for disqualifying persons from serving in various capacities to investment companies. See discussion of *Section 509*, below.

Sections 217(3), 219, and 602(3) would clarify ambiguities in sections 15(b)(6) and 15B(c)(4) of the 1934 Act and in section 203(f) of the Investment Advisers Act of 1940. These amendments would codify the Commission's interpretation that it has jurisdiction under those sections to bring administrative proceedings against persons who were associated with, or were seeking to become associated with, a broker-dealer, municipal securities dealer, or investment adviser at the time they committed an alleged violation of the federal securities laws, regardless of their current employment or association status.

Before 1975, section 15(b)(7) of the 1934 Act and section 203(f) of the Investment Advisers Act authorized the Commission to bring administrative proceedings and to censure or suspend for not more than 12 months from the broker-dealer and investment advisory businesses "any person" found to have made false statements to the Commission, or to have otherwise violated the federal securities laws or aided or abetted a violation.

At that time, based on the plain language of these sections, the Commission brought a number of administrative proceedings under section 15(b)(7) against banks, lawyers, and other persons who had allegedly violated the federal securities laws, but who had not been and were not engaged in the securities business as brokers, dealers, or investment advisers, and had no apparent intention of becoming so engaged.⁴ As mentioned above, the only sanction the Commission could impose under sections 15(b)(7) and 203(f) were censure, suspension, or a bar from the business of broker-dealer or investment adviser, respectively.

Apparently, objections were raised as to the logic and fairness of imposing these sanctions in administrative proceedings on persons who were not subject to regulation by the Commission as registered broker-dealers and investment advisers and had no intention of entering the businesses associated, or seeking to become associated, with or from which they might be suspended or barred.⁵ In apparent response to these objections, section 15(b)(7) (renumbered section 15(b)(6)) was changed in 1975 to refer to "any per-broker or dealer," rather than to "any person," and section 203(f) was

⁴ 5 Loss, Securities Regulation 3386-87 (1969).

⁵ See II American Law Institute, Federal Securities Code 870 (1980).

changed to refer to "any person associated or seeking to become associated with an investment adviser."⁶ Section 15B(c)(4), which was added to the 1934 Act by the 1975 amendments and applies to associated persons of municipal securities dealers, follows the same pattern.

This phrasing creates a possible ambiguity, however. It raises the possibility of an argument that a person who was associated with a broker-dealer, municipal securities dealer, or investment adviser at the time of the violation, but who is no longer so associated at the time of the bringing of an administrative proceeding, could not be the subject of such a proceeding. It also raises the possibility of an argument that someone who was seeking to become associated with a broker-dealer, municipal securities dealer, or investment adviser at the time of alleged misconduct, but is not seeking such association at the time of an administrative proceeding, cannot be subject of the proceeding.

These interpretations would clearly be contrary to the purposes of the sections, however, since they would allow persons who had violated the federal securities laws to avoid administrative sanctions merely by leaving the business and stating that they were longer associated with a broker-dealer, municipal securities dealer, or investment adviser and were not seeking to become so associated. This situation could arise, for example, if an employee charged with violations resigned his employment or, in the case of principals of a firm, resigned or caused the firm to cease doing business. It could also arise if someone who files a fraudulent application for registration abandons the application.

The proposed amendments correct this potential problem by inserting, in sections 15(b)(6), 15B(c)(4), and 203(f), the phrase "or, at the time of the alleged misconduct, associated or seeking to become associated." These amendments make clear Congress' original intent that misconduct during a *past* association or attempt at association, as well as during a *present* or *prospective* association, subjects a person to administrative proceedings and sanctions under the Securities Exchange Act and the Investment Advisers Act.

The proposed amendments follow closely the language and the rationale of section 1809(a) of the American Law Institute's Federal Securities Code.⁷ There the proposed statutory language subjects a

⁶ The definition of "associated person" does not include lawyers, banks, or other persons unless they are employed in the securities business or are in a control relationship with a broker-dealer or investment adviser.

Section 3(a)(18) of the 1934 Act defines the term "person associated with a broker or dealer" as

any partner, officer, director, or branch manager of such broker or dealer (or any person occupying a similar status or performing similar functions), any person directly or indirectly controlling, controlled by, or under common control with such broker or dealer, or any employee of such broker or dealer, except that any person associated with a broker or dealer whose functions are solely clerical or ministerial shall not be included in the meaning of such term for purposes of section 15(b) of this title (other than paragraph (6) thereof). Similarly, section 202(a)(17) of the Investment Advisers Act defines "person associated with an investment adviser" as

any partner, officer, or director of such investment adviser (or any person performing similar functions), or any person directly or indirectly controlling or controlled by such investment adviser, including any employee of such investment adviser, except that for the purposes of section 203 of this title (other than subsection (f) thereof), persons associated with an investment adviser whose functions are clerical or ministerial shall not be included in the meaning of such term.

⁷ II American Law Institute, Federal Securities Code § 1809(a) (2d Supp. 1981).

person to liability who "is, was at the time of any conduct alleged [to be a violation] * * * or is seeking to become * * * an associate" (emphasis supplied). The commentary on this section in effect acknowledges that it would be merely codification of present law: "[I]t does seem fair enough to make clear that the Commission can proceed against a person who *was* a broker, etc., *at the time of the alleged conduct*" (emphasis in original).⁸

Section 217(4) would correct an apparent typographical error in section 15(b)(10) of the 1934 Act, where there is a cross reference to "statutory disqualification" under section 17A(b)(4)(B), but that section does not use the term "statutory disqualification," whereas section 17A(b)(4)(A) does use the term, and it is apparent that the correct reference is section 17A(4)(A).

Section 218 would correct several obvious typographical errors in section 15B(b)(2)(C) of the 1934 Act.

Section 219 would effect two changes in section 15B(c)(4) of the 1934 Act, which deals with administrative proceedings against persons associated with municipal securities dealers. The first change would conform the remedies available against persons associated with municipal securities dealers to those provided in parallel provisions of the federal securities laws for persons associated with broker-dealers and investment advisers. The second change would clarify that administrative proceedings may be instituted against a person who was associated or seeking to become associated with a municipal securities dealer at the time of the conduct complained of. See discussion of Section 217(3), above.

The first amendment would make it clear that the Commission and other appropriate regulatory agencies may "place limitations on the activities or functions" of a person associated with a municipal securities dealer.⁹ At present, the language of section 15B(c)(4) authorizes the agencies to impose against such persons the sanctions of censure, suspension, and bar. The other provisions of the securities laws that deal with permissible sanctions against persons associated with broker-dealers and investment advisers, however, allow the Commission to censure, suspend, or bar them and also to *place limitations on their activities*.¹⁰

The omission of specific language giving the Commission and the other agencies "limitations" authority with respect to persons associated with municipal securities dealers is not explained in the legislative history of section 15B(c)(4). Indeed, the legislative history suggests that the omission was an oversight. The Senate Report that accompanied the Securities Acts Amendments of 1975, which added section 15B(c)(4) to the Act, indicated that the provision was intended to provide "limitations" authority. The Report stated that section 15B(c)(4) would authorize the Commission "by order, to censure or *impose limitations on the functions and activities*, or bar or suspend * * * any person from being associated with a municipal

⁸ *Id.* at 870 (1980).

⁹ Section 15B(c)(5) of the Act allows other "appropriate regulatory agencies" to impose on municipal securities dealers and associated persons within their jurisdictions the same sanctions that Sections 15B(c)(2) and (4) authorize the Commission to impose. The appropriate regulatory agency for a bank-affiliated municipal securities dealer is defined in Section 3(a)(34)(A) of the Act as one of several federal bank regulatory authorities. See note 2, above.

¹⁰ 1934 Act § 15(b)(6), 15 U.S.C. 78a(b)(6); Investment Advisers Act § 203(f), 15 U.S.C. 80b-3(f).

securities dealer.”¹¹ However, neither at the time the 1975 bill was reported, nor when it was enacted into law, did its actual text ever include a reference to “limitations.”¹²

Additional evidence that the lack of express “limitations” authority in section 15B(c)(4) was an oversight is found in section 15B(c)(2) of the Act, which was added at the same time as section 15B(c)(4). Section 15b(c)(4) sets out the permissible sanctions applicable to municipal securities dealers themselves. It expressly confers “limitations” authority upon the Commission and the other appropriate regulatory agencies. There is no explanation in the legislative history for the difference in treatment of municipal securities dealers and persons associated with municipal securities dealers. In the sections of the securities laws dealing with sanctions applicable to other registrants and their associated persons, there is “limitations” authority with respect to both.¹³

The proposed amendment would remedy this apparent oversight and conform the provisions governing the sanctions expressly applicable against persons associated with municipal securities dealers to those applicable against persons associated with other dealers and with brokers and investment advisers.¹⁴ The Commission regards this as a desirable change in the law because the limitations authority is an important recognition by Congress of the need for flexibility to fashion sanctions that fit the offense and situation presented. For example, the Commission may use its “limitations” authority in the broker-dealer area to suspend the operation of a single branch office, rather than an entire firm, where misconduct was localized; or to confine an offending employee to nonsupervisory positions where an outright bar or suspension is unnecessary; or to bar persons formerly associated with broker-dealers from entering other securities professions where they might continue to perpetrate frauds upon unsuspecting investors.

Section 220 would capitalize the word “broad” in section 15B(c)(A) of the 1934 Act and thereby remove any ambiguity as to whether it refers to the defined term “Board” used elsewhere in the Act.

Section 221(1) would amend section 17(c)(2) of the 1934 Act to require that the Commission and the federal banking agencies, which serve as regulatory agencies for transfer agents and municipal securities dealers, to notify each other when they institute proceedings and enter orders against persons associated with transfer agents and municipal securities dealers. Currently, section 17(c)(2) requires the Commission and the banking agencies to notify each

¹¹ S. Rep. No. 94-75, 94th Cong., 1st Sess. 116 (1975).

¹² See *id.* at 215.

¹³ See 1934 Act § 15b(c)(4), (b)(6), 15 U.S.C. 78a(b)(4), (b)(6); Investment Advisers Act § 203(e), (f), 15 U.S.C. 80b-3(e), (f).

¹⁴ If the municipal securities dealers with which the person is associated is also a broker-dealer against which the Commission may proceed under section 15(b) of the Act, of course, the Commission can proceed against the associated person under the general sanctioning provisions of section 15(b)(6), which contains express “limitations” sanctioning authority. The definitions in the 1934 Act, however, prevent the Commission from sanctioning a bank-affiliated municipal securities dealer or its associated persons under section 15(b). Instead, the Commission must rely on section 15B(c), which addresses municipal securities dealers specifically. Thus, the principal effect of the proposed amendment would be expressly to permit the Commission to place limitations on persons associated with bank-affiliated municipal securities dealers. See 1934 Act §§ 3(a)(5), 3(a)(30) & 3(a)(32), 15 U.S.C. 78c(a)(5), 78c(a)(30), 78c(a)(32).

other only when they institute proceedings and enter orders against transfer agents and municipal securities dealers themselves, not when they do so against associated persons only. The purpose of the requirement is to foster cooperation among government agencies in law enforcement and regulation. See S. Rep. No. 94-75, 95th Cong., 1st Sess. 120-21 (1975). The extension of the requirement to proceedings and orders against associated persons is consistent with this purpose and is the approach adopted in the American Law Institute's *Federal Securities Code*.¹⁵ Section 15B(c)(6) of the 1934 Act already requires the Commission and the banking agencies to notify and consult with each other before entering orders of investigation and commencing proceedings against both municipal securities dealers and associated persons of municipal securities dealers. Therefore, the extension of the section 17(c)(2) requirement to associated persons of municipal securities dealers should not impose any significant burdens on the agencies. The extension to associated persons of transfer agents is consistent with Section 222(5) of the bill, which would extend the administrative jurisdiction of the agencies to such persons. Moreover, the requirement that the agencies file with each other copies of orders imposing sanctions on persons associated with transfer agents would facilitate the employment review process contemplated under Section 222(5).

Section 221(2) would amend section 17(f)(2) of the 1934 Act to provide the Commission and self-regulatory organizations ("SRO's") designated by the Commission with access, in connection with the identification and processing of fingerprints taken in satisfaction of the fingerprinting requirement of section 17(f)(2), to all criminal history record information in the FBI's National Crime Information Center system. The amendment is specifically intended to enable the NASD and other SRO's that have plans for the processing of fingerprint cards approved by the Commission to obtain complete arrest information on prospective employees of their members.

At present, the SRO's are unable to obtain complete arrest information in connection with section 17(f)(2) fingerprint submissions because of Department of Justice regulations. The regulations prohibit the release to the SRO's of arrest information not accompanied by information relating to the disposition of the arrest if the arrest information is more than one year old and no active prosecution of the case is known to be pending. See 28 C.F.R. §§ 20.33, 50.12 (1986). Under current law, the Commission itself could obtain such arrest information, but the proposed amendment covers the Commission so as not to raise a negative implication that the self-regulatory organizations could obtain access while the Commission could not.

A restriction on release of year-old arrest data not accompanied by disposition data where there is no known active prosecution is not, on its face, unreasonable. But such a restriction is not advisable when the purpose of a fingerprint submission is the investigation of prospective employees in the securities business who will

¹⁵ See II American Law Institute, *Federal Securities Code* § 1803(f)(2), at 828 (1980).

handle and act as fiduciaries with respect to large amounts of other peoples' money. Moreover, arrest data may not be accompanied by disposition data for reasons entirely unrelated to the seriousness of the arrest. There may be delays in the disposition of arrests, and local law enforcement officials sometimes fail to report dispositions, even convictions, to the FBI. As a consequence, the SRO's and their members can be prevented by the regulations from receiving precisely the kind of information they need to identify potentially untrustworthy personnel and make informed hiring decisions about persons convicted of securities-related offenses.

The proposed amendment would provide the SRO's with access similar to that granted by section 233 of the Futures Trading Act of 1982, Public Law No. 97-444, 96 Stat. 2294, to registered futures associations, which are regulated by the Commodity Futures Trading Commission ("CFTC"). Frequently, prospective employees who are subject to the jurisdiction of a registered futures association, which is in essence a futures SRO, are also subject to the jurisdiction of a securities SRO. Since trustworthiness concerns are as important in the securities industry as they are in the futures industry, it is appropriate that securities SROs have access to the same type of information as futures SROs. Moreover, restricting securities SRO access to criminal history record information contributes to duplicative fingerprint and background investigation requirements when employees move from the securities industry to the futures industry by changing jobs or by expanding their product lines. Currently, sales personnel whose fingerprints have been processed by the FBI and are on file with the CFTC are exempt from the SEC's fingerprinting requirement. The CFTC does not have a reciprocal exemption, however, because the information provided by the FBI to securities SROs does not include the more extensive arrest information available to registered futures associations regulated by the CFTC. By granting access to such information to securities SROs, the amendment would enable the CFTC to consider adopting an exemption that would eliminate dual fingerprint and background investigation requirements.

The amendment would also remove a reference to section 17(f)(2), the statutory provision on fingerprinting, that now appears in section 17(f)(3)(A), which addresses access to information for use in the lost and stolen securities program described in section 17(f)(1).

Section 222 of the bill would amend the provisions in section 17A of the 1934 Act relating to regulation of transfer agents. The purpose of the amendments is to improve compliance with those provisions. The amendments would place the enforcement authority of the Commission and the federal bank regulatory agencies with respect to transfer agents and transfer agent professionals¹⁶ on a par with their authority over brokers, dealers, municipal securities dealers, and investment advisers and their associated professionals.

Transfer agent regulatory authority was added to the 1934 Act by Congress in 1975. See Pub. L. No. 94-29, § 15, 89 Stat. 141. Thus,

¹⁶ Section 3(a)(34)(B) of the 1934 Act provides that the Comptroller of the Currency, the Federal Reserve Board, or the Federal Deposit Insurance Corporation is the "appropriate regulatory agency" for a transfer agent that is a bank within its primary regulatory jurisdiction, or the subsidiary of such a bank, and that the Commission is the "appropriate regulatory agency" for all other transfer agents.

the proposed amendments reflect ten years' experience in federal regulation of transfer agents.

The amendments were developed in consultation with the staffs of the other transfer agent regulatory agencies—the Comptroller of the Currency, the Federal Reserve Board, and the Federal Deposit Insurance Corporation. The staffs of all three agencies offered support for the legislation.

The Securities and Exchange Commission believes that the proposed changes would enhance significantly the enforcement capabilities of the transfer agent regulatory agencies. The proposed legislation would close existing gaps in administrative authority and would provide important, flexible tools with which the Commission and the other agencies more efficiently may remedy violations of the federal securities laws by registered transfer agents and their associated professionals.

Section 222(1) would amend section 17A(c)(2) of the 1934 Act to make it clear that the Commission or the other appropriate regulatory agency for a transfer agent may require information about professionals associated with the transfer agent in the transfer agent's application for registration. The clarification is desirable in view of *Section 223(5)* of the bill, which would extend the adjudicative jurisdiction of the agencies to professionals associated with transfer agents.

Section 222(2) would amend section 17(A)(c)(2) of the 1934 Act to extend the effective date of a transfer agent's registration from 30 days to 45 days after the filing of the application, as is the case for brokers and dealers. The additional processing time is needed for the agencies to review the additional information about professionals that may be required under the amendment provided for in *Section 222(1)*, discussed above. The existing provision allowing the agencies to accelerate the effectiveness of the registration would not be changed.

Section 222(3) would redesignate current subparagraphs (B) and (C) of section 17A(c)(3) of the 1934 Act as subparagraphs (A) and (B) of new section 17A(c)(4). This would accommodate the amendments of section 17A(c)(3) accomplished under *Section 222(4)*.

Section 222(4) would amend section 17A(c) of the 1934 Act, the section of that statute that provides for the institution of administrative proceedings against transfer agents, in two ways. First, it would permit the appropriate regulatory agency for a transfer agent to institute administrative proceedings against, and impose sanctions on, the transfer agent for acts committed or omitted by professionals associated with the transfer agent itself. The new scheme would conform the regulation of transfer agents to the rules that apply to broker and dealers, which are subject to administrative proceedings both for their own acts and for acts of their associated persons.

Second, *Section 222(4)* would significantly expand the grounds for instituting administrative proceedings against, and imposing sanctions on, transfer agents. The current statute authorizes administrative proceedings and sanctions only for violations of, or inability to comply with, sections 17 and 17A of the 1934 Act and the rules thereunder. Sections 17 and 17A and their accompanying rules are quite narrow in scope. They prescribe statutory and regulatory re-

quirements only with respect to maintaining books and records and clearing and settling securities transactions. The amendment would expand the grounds for sanctioning transfer agents to include those currently available for sanctions against brokers, dealers, and municipal securities dealers. The grounds include violations by transfer agents and their associated persons of the federal securities laws; convictions and injunctions relating to financial activities such as banking, insurance, commodity futures, and securities-related businesses; and convictions for offenses involving fraud or dishonesty. The grounds are set out in detail in subparagraphs (A) through (E) of section 15(b)(4) of the 1934 Act, which would be incorporated by reference in section 17A(c)(3) under the proposed amendment. An outstanding order barring or suspending the transfer agent or one of its associated persons from associating with a transfer agent also would constitute grounds for an administrative sanction. This is comparable to the provision that applies to brokers and dealers in section 15(b)(4)(F) of the 1934 Act.

The legislative history of section 17A(c)(3), which was added by Congress to the 1934 Act in 1975, does not disclose why the adjudicative authority of the transfer agent regulatory agencies is limited to violations of sections 17 and 17A. The Commission's experience over the last ten years in administering the federal securities laws relating to transfer agent activities, however, indicates that transfer agents can use their position as recordkeeper and certificate processor for issuers to violate other federal and state laws that outlaw fraud and deception and regulate the provision of financial services. However, if a transfer agent violates, for example, the antifraud provisions of the securities laws, the Commission and the other transfer agent regulatory agencies cannot now bring an administrative proceeding under section 17A(c)(3) to revoke, deny, or suspend registration or to censure or place limitations on the activities of the transfer agent, absent violations of section 17 or 17A or the rules thereunder.

Transfer agents that violate other provisions of the federal securities laws, of course, occasionally also violate section 17 or section 17A of the 1934 Act.¹⁷ In such cases, however, under current law, the Commission may be required to bring two separate proceedings to satisfy the public interest. The Commission would have to institute administrative proceedings to revoke the transfer agent's registration on the basis of section 17 or 17A violations, and seek an injunction from a court to redress the violations of other provisions of the federal securities laws, if the public interest required both sanctions. Moreover, transfer agents and their associated persons that violate other provisions of the federal securities laws may operate their transfer agency in substantial compliance with sections 17 and 17A or may be able to cure any minor section 17 or 17A violation easily. In those cases, the public interest and investor protection may not justify severe administrative sanctions, such as revocation or registration, for the section 17 or 17A violations, even

¹⁷ See, e.g., *International Postal Systems, Inc.*, Securities Exchange Act Release No. 14901 (June 28, 1978) (administrative proceedings to determine whether to deny registration to a transfer agent involved in violations of section 5(a) of the 1933 Act and section 10(b) of the 1934 Act, on the basis of violations of section 17A(c)(1) of the Act).

though the violations of other provisions of the federal securities laws might merit such remedies.

The proposed amendment would close this gap in the administrative authority of the Commission and the other transfer agent regulatory agencies. It would confer upon them administrative adjudicatory authority comparable to that applicable to brokers, dealers, municipal securities dealers, and investment advisers.¹⁸ The agencies thus would be able to tailor administrative remedies in cases of multiple violations and would not be required to rely exclusively on section 17 or 17A violations.

Section 223(5) would add a new paragraph (4)(C) to section 17A(c) of the 1934 Act. As mentioned above, the new provision would permit the Commission or the other appropriate regulatory agency for a transfer agent to institute administrative proceedings against, and impose sanctions on, persons associated with the transfer agent. At present, the Commission and the other transfer agent regulatory agencies can bring administrative proceedings only against the transfer agent itself. The grounds for instituting proceedings against, and imposing sanctions on, associated persons of transfer agents would be the same as those applicable to other securities professionals, including violations of the securities laws and convictions and injunctions relating to financial services industry activities. The available sanctions also would be the same—bar, suspension, censure, and placing of limitations on the activities of the transfer agent professional.

New paragraph (4)(C) of section 17A(c) also would make it unlawful for a person subject to a bar or suspension from associating with a transfer agent to become so associated without the consent of both the appropriate regulatory agency that entered the bar or suspension and the appropriate regulatory agency for the transfer agent with which the person wishes to associate, if different. Likewise, it would be unlawful for a transfer agent to knowingly or negligently permit a person subject to such a bar or suspension to associate with it without the consent of both the appropriate regulatory agencies.

To enable a transfer agent to determine whether a person associated or seeking to become associated with it is subject to a bar or suspension, the legislation authorizes the Commission to establish procedures to allow transfer agents to obtain the relevant information. The Commission contemplates that, in exercising this authority to establish procedures, it will consult with the other transfer agent regulators and weigh carefully the statutory objectives against paperwork, reporting, and recordkeeping burdens. Recent Commission experience and consultations with the other agencies indicates that no more than a handful of bars and suspensions would be issued in any given year. It would be possible, therefore, for each transfer agent regulatory to disseminate notice of these actions to all registered transfer agents, and to require that all transfer agents maintain a file of these notices. The transfer agents could be required to check this file before permitting a professional to associate with them. This alternative may be less burdensome

¹⁸ See 1934 Act §§ 15(b) (4) and (6), 15B(c) (2) and (4); Investment Advisers Act §§ 203 (e) and (f).

than establishing or appointing a central repository of the information and requiring a transfer agent to inquire of the repository each time a professional seeks association.

Under the current statutory scheme, the Commission and the federal banking regulatory agencies are empowered to impose administrative sanctions on transfer agents as entities, but not on persons associated with transfer agents, even if those persons are directly responsible for violations of the federal securities laws.¹⁹ Moreover, although the Commission can revoke the registration of a transfer agent, it cannot, without cumbersome proceedings, prevent culpable associated persons from establishing a new transfer agent and continuing their unlawful activities.²⁰ Administrative authority over associated persons is therefore essential if the Commission is to fashion efficient enforcement remedies that satisfy the public interest.

The existing statutory scheme unduly hampers Commission enforcement capabilities. For example, in *Corporate Registrar and Transfer Company* ("CR&T"),²¹ the Commission instituted administrative proceedings against a transfer agent for violations of sections 17 and 17A of the Act. The Commission, however, could not impose administrative sanctions on the associated person responsible for the transfer agent's violations.²² Moreover, although the associated person consented to revocation of the transfer agent's registration, the associated person acquired another transfer agent and assigned to it all of the assets and clients of CR&T.²³

The proposed legislation would rectify these enforcement limitations. The Commission and the other transfer agent regulatory agencies would be able to tailor appropriate remedial sanctions against associated persons, as is currently the case with associated persons of registered broker-dealers, municipal securities dealers, and investment advisers, through censure, limitation of activities, suspension, and bar of association. Furthermore, the Commission would be able efficiently to revoke or deny the registration of a transfer agent on the basis of an associated person's prior misconduct.

Sections 222(6) and 222(7) would add references to persons associated with a transfer agent to sections 17A(d)(3)(B) and 17A(d)(4) of

¹⁹ The federal bank regulatory agencies may have authority under other federal statutes to remedy violations by associated persons. See, e.g., 12 U.S.C. 1818 (1976).

²⁰ Contrast these limitations with the provisions pertaining to administrative authority over brokers and dealers and persons associated with brokers and dealers. Under section 15(b)(6) of the Act, for example, the Commission could place limitations on association with a broker or dealer on the ground that the associated person previously violated the federal securities laws. Furthermore, under section 15(b)(4) of the Act, the Commission could deny registration to an applicant broker or dealer on the ground that an associated person previously violated the federal securities laws.

²¹ Securities Exchange Act Release No. 20765 (Mar. 19, 1984).

²² See also *National Bond and Share Company*, SEC Litigation Release No. 9898 (Feb. 17, 1983), in which the Commission obtained an injunction against both the transfer agent and its controlling person after the Commission suspended trading in five shell companies for which the transfer agent performed transfer functions. The Commission later brought administrative proceedings against the transfer agent for violations of sections 17 and 17A of the 1934 Act and several rules thereunder, but was unable to seek administrative remedies against the individual. See Securities Exchange Act Release No. 19638 (Mar. 29, 1983).

²³ Under the proposed scheme, the Commission could have prevented such a clear circumvention of its enforcement program easily and efficiently. The Commission might have sanctioned the associated person for his part in the violations of sections 17 and 17A. It then could have revoked the registration of the newly acquired transfer agent on the ground that an associated person previously violated the federal securities laws.

the 1934 Act. Section 17A(d)(3)(B) provides that nothing in the Act should be construed to limit the Commission's authority to make rules pursuant to the Act and to enforce compliance by transfer agents and clearing agencies. Section 17a(d)(4) provides that nothing in section 17A should be construed to impair the authority of any state or federal regulatory authority having jurisdiction over transfer agents and clearing agencies to make or enforce rules governing such agents and agencies that are not inconsistent with the 1934 Act. The new references are advisable in recognition of the new authority over associated persons of transfer agents that *Section 222* would provide.

Section 223(1) would correct an apparent typographical error in section 21(d) of the 1934 Act, where the word "wherever," rather than the word "whenever," is used to indicate the time at which something may be done.

Section 223(2). See discussion of *Section 108*, above.

Section 223(3). See discussion of *Section 206*, above.

Section 224(1) would insert in section 23(a)(1) of the 1934 Act the conjunction "or" before the last of a number of items in a series where a disjunctive conjunction obviously is required.

Section 224(2) would insert the verb "shall" before the word "keep" in a sentence in section 23(a)(3) of the 1934 Act that otherwise would read: "The Commission * * * keep in a public file * * *."

Section 225 would set in lowercase the letter "t" in the word "the" in section 23(b)(4)(F) of the 1934 Act. The word does not appear at the beginning of a sentence and does not otherwise require initial capitalization.

Section 226. See discussions of *Sections 108 and 109(3)*, above.

Section 227 would correct an apparent typographical error in section 28(c) of the 1934 Act. It appears that the word "or" was inserted in section 28(c) instead of the word "on," because, as written, section 28(c) speaks of sanctions imposed by members of self-regulatory organizations and by persons associated with members. These concepts are totally foreign to the 1934 Act. The inapt language can be harmonized with the remainder of section 28 by amending it to refer to a "disciplinary sanction imposed by a self-regulatory organization on a member thereof."

Section 228 would correct a typographical error in section 28(d) of the 1934 Act, where the word "is," instead of the word "in," is used in what is obviously intended to be the phrase "change in beneficial or record ownership."

Section 229 would amend a reference in section 28(e)(1) of the 1934 Act from the "Securities Act Amendments in 1975" to the "Securities Acts Amendments of 1975."

Section 230 would delete section 211 of the 1934 Act. Section 211 provided for a study and report by the Commission of reorganization proceedings. The report was completed and became the basis for the Trust Indenture Act of 1939.

TITLE III

The Title III of the Bill would effect various nonsubstantive and noncontroversial amendments to the Public Utility Holding Company Act of 1935 ("PUHCA").

Section 301 would conform section 8 of PUHCA to the *Government Printing Office Style Manual* rule that a dash is not used immediately after a comma.

Sections 302 through 304. *Section 302(1)* redesignates subsections (f) and (g) of section 18 of PUHCA to eliminate the nonconsecutive subsection designations that resulted from the repeal of subsection (e) by Public Law No. 91-452 in 1970. *Sections 302(2), 303, and 304* would make the conforming changes discussed above in connection with the discussion of *Sections 106, 108, and 109*. In addition, *Section 304(2)* would delete a reference in section 25 of PUHCA to the 1893 statute that established a court of appeals for the District of Columbia. The statute was repealed in 1949. The rights of appeal provided for in the statute are now provided for in 28 U.S.C. 1254, 1291, 1292, and 1294, to which section 25 would refer under the proposed amendment. *Section 607* would delete a similar reference in section 214 of the Investment Advisers Act of 1940 for the same reasons.

Section 305 would delete from section 30 of PUHCA the sentence that provided for the study and report that led to enactment of the Investment Company and Investment Advisers Acts of 1940.

TITLE IV

Title IV would effect several amendments of the Trust Indenture Act of 1939.

Section 401 would correct an obvious typographical error in section 303(4) of the Act, where the word "undertaking" is spelled "undertakng."

Section 402 would amend the definition of the term "obligor" in section 303(12) of the Act to clarify that a guarantor is an obligor with respect to indenture securities under the Act. The amendment reflects current administrative practice and is beneficial in eliminating the necessity to interpret the term "obligor" to include a guarantor.

TITLE V

Title V would effect a number of amendments of the Investment Company Act of 1940.

Section 501 would amend the definition of the term "interested person" in section 2(a)(19) of the Investment Company Act by inserting the word "completed" before the words "fiscal years" each time the latter words appear. The words "two fiscal years" are used in the definition of the term "interested person" as a test of the materiality of certain business relationships immediately before the time in question. The revision conforms with SEC staff interpretations and removes an ambiguity in the present law.

Section 502. See discussion of *Section 102*, above.

Section 503 would correct an apparent typographical error in section 2(a)(48)(B) of the Investment Company Act, where the word "sections," instead of the word "section," is used before "55(a)(1)

through (3)," by amending the provision so that it refers to "paragraphs (1) through (3)," which is the preferred usage.

Section 504 would delete the last clause of section 3(c)(3) of the Investment Company Act, which was intended to, and effectively did, create an exemption from the Act for the Massachusetts Hospital Life Insurance Company. The "Massachusetts Company," the successor to that company, no longer requires the exemption.

Section 505 would delete as obsolete section 3(c)(7) of the Investment Company Act. Section 3(c)(7) exempts from the operation of the Act companies subject to regulation by the Interstate Commerce Commission under Section 11302 of title 49, United States Code (section 214 of the Interstate Commerce Act before the enactment of title 49 in 1978), and certain holding companies controlled by companies subject to regulation under section 11302. Section 11302 provided for regulation by the Interstate Commerce Commission of the securities activities of interstate motor vehicle carriers. It was repealed by section 19(a) of the Bus Regulatory Reform Act of 1982, Pub. L. No. 97-271, § 19(a), 96 Stat. 1121. Since there are no longer any companies subject to regulation under section 11302, section 3(c)(7) of the Investment Company Act has no force and effect, and should be repealed. The bill would reserve the paragraph (7) designation for future use, rather than renumber the succeeding paragraphs, to avoid the confusion that would result from renumbering these frequently-cited provisions of law.

Section 506(1) would amend Section 3(c)(11) of the Investment Company Act to change all references to the Internal Revenue Code of 1954 to the Internal Revenue Code of 1986, to reflect the passage of the Tax Reform Act of 1986.

Sections 506 (2) and (3) would amend section 3(c)(11) of the Investment Company Act to make clear that a governmental plan described in that section need not be a trust to be exempted from the operation of the Act. The purpose of this amendment is to carry out Congress' apparent intent when it amended the Investment Company Act in the Small Business Investment Incentive Act of 1980.

Section 3(c)(11) does not specifically provide for the exemption of collective trust funds consisting solely or partially of assets of governmental plans not held in a trust. But the clear intent and purpose of Congress in amending section 3(c)(11) in 1980 was to conform section 3(c)(11) to section 3(a)(2) of the 1933 Act. Section 3(a)(2) was amended by the same legislation to exempt from application of the registration provisions of the 1933 Act any interest in a collective trust fund maintained by a bank issued in connection with a governmental plan, without requiring that the plan's assets be held in trust before it invested in the fund. See 126 Cong. Rec. 21,272-74 (1980) (remarks of Senator Sarbanes); 126 Cong. Rec. 28,632 (1980) (remarks of Representative Scheuer). The proposed amendment thus merely corrects a draftsman's oversight and codifies the current Commission staff interpretation of section 3(c)(11). Moreover, the proposed amendment is consistent with the action of Congress in 1982 when it amended the Internal Revenue Code to provide that a group trust that otherwise meets the requirements of section 401 of the Code shall not be treated as not meeting those requirements on account of the participation or inclusion in the trust of

money of a governmental plan. The House Report on the legislation stated that the tax-exempt status of a group trust would not be affected adversely because the trust accepts money from a governmental plan "whether or not * * * the the assets are held in trust." H.R. Rep. No. 97-760, 97th Cong., 2d Sess. 640 (1982).

Section 507 would correct an obvious typographical error in section 5(a)(2) of the Investment Company Act, where "Closed-end" is spelled "Close-end."

Section 508(1). See discussion of *Section 102*, above.

Section 508(2) would remove as obsolete the exemption in section 6(a)(2) of the Investment Company Act for companies for which a receiver, trustee in bankruptcy, or similar officer had been appointed by a court before the effective date of the Act, so long as the conduct of the company's business remains subject to the supervision of the court. The Commission knows of no company that meets the conditions for the exemption today, and it is highly unlikely that any such company exists.

Section 509 would amend section 9(a) of the Investment Company Act to add an additional kind of conduct to the existing list of activities that give rise to disqualification under the provision. The kinds of conduct that would be added is a convictions or injunctions in connection with activities of transfer agents.

Section 9(a) disqualifies persons who have been convicted of certain crimes, or against whom certain injunctions have been issued, from serving in the management, as employees, as investment advisers, or as principal underwriters of investment companies without an order granted by the Commission under section 9(c). At present, the list of disqualifying items includes injunctions and convictions of crimes arising out of the person's conduct as an underwriter, broker-dealer, or investment adviser, municipal securities dealer, government securities broker, government securities dealer, or entity or person required to be registered under the Commodity Exchange Act, or as an affiliated person, salesman, or employee of an investment company, bank, or insurance company, or entity or person required to be registered under the Commodity Exchange Act. Section 9(b) gives the Commission authority to disqualify a person for willful violations of, or for willfully aiding and abetting violations of, the 1933 Act, the 1934 Act, the Investment Company Act, the Investment Advisers Act and the Community Exchange Act.

Sections 9(a) and (b) serve essentially the same purpose as section 15(b)(6) of the 1934 Act and section 203(f) of the Investment Advisers Act, which give the Commission authority to bar persons from association with broker-dealers and investment advisers on the basis of specified convictions, injunctions, and violations. The Investment Company Act and the Advisers Act, unlike the 1934 Act, however, do not include, among the specific bases for disqualification, convictions and injunctions relating to transfer agent activities. *Section 509* would close this gap in the Investment Company Act and substantially conform the 1934 Act, the Investment Company Act, and the Investment Advisers Act in this respect. *Sections 602 (1) and (2)* would effect corresponding changes in the Investment Advisers Act.

Section 510 would correct three obvious typographical errors in section 12 of the Investment Company Act. In one instance, the word "treasury" is capitalized when referring to the "treasury stock" of an investment company. In another, the word "it," instead of the word "is," is used in what is obviously intended to be the phrase "as is reasonably possible." Finally, the words "thereof" and "only" are transposed in the phrase "own all or any part of the capital stock thereof only if such stock is acquired and held for investment."

Section 511(1) would correct an erroneous cross-reference to paragraph 40 of section 2(a) in section 15(d) of the Investment Company Act. Section 2(a)(2) of the 1970 Amendments to the Investment Company Act redesignated paragraph (40) as paragraph (42), but section 15(d) was not amended to reflect the redesignation.

Section 511(2) would correct an obvious typographical error in section 15(f)(3)(B) of the Investment Company Act, where a period, instead of a comma, is used in the middle of a sentence.

Section 512 would delete as obsolete the second sentence of each of section 17(h) and section 17(i) of the Investment Company Act. The second sentences of both sections provide that the prohibitions of the section will not be deemed violated if noncomplying language in effect on the effective date of the Investment Company Act is amended to comply with the sections within one year of that date or if, if not so amended, persons who would otherwise be protected under the language file waivers with the Commission. We are not aware of any such waivers that have been filed that are still in effect.

Section 513 would delete as obsolete paragraph (1) of section 18(e) of the Investment Company Act. Paragraph (1) makes inapplicable the prohibitions of section 18, which relate to the capital structure of investment companies, to senior securities issued or sold by any registered closed-end company pursuant to a firm contract to purchase or sell entered into before March 15, 1940.

Section 514 would delete as obsolete two sentences in section 20 of the Investment Company Act and would remove superfluous language in section 20(d). This first sentence to be removed as obsolete is the second sentence of section 20(b), which makes the prohibition in that section on the use of interstate commerce to sell voting-trust certificates inapplicable to a class of voting-trust certificates if any certificates of the class were publicly offered by the issuer before March 15, 1940. The second sentence to be removed as obsolete is the first sentence of section 20(d), which required elimination of cross and circular ownership of investment companies, which are prohibited by section 20(c), within five years of enactment of the Act.

Section 515 would delete as obsolete the exemption in section 21(b) of the Investment Company Act for the extensions or renewals of loans made before March 15, 1940. Section 21(b) generally makes it unlawful for any registered management company to lend money or property to persons in control of the company.

Section 516(1) would correct an obsolete cross-reference in section 22(b)(1) of the Investment Company Act from section 15A(b)(8) of the 1934 Act to section 15A(b)(6). The provisions contained in section 15A(b)(8) before the 1975 amendments to the 1934 Act are now

contained in section 15A(b)(6), but the cross-reference to section 15A(b)(8) has never been changed.

Section 516(2) would delete as obsolete paragraph (2) of section 22(b) of the Investment Company Act and renumber the remaining paragraphs of the section. Paragraph (2) gave the Commission authority to adopt rules with respect to excessive sales loads in primary distributions of redeemable securities of investment companies. The rules were applicable to broker-dealers regulated by the Commission under its "SECO" (SEC only) program. The rules were necessary because broker-dealers regulated under the SECO program were not members of the NASD and not bound by the NASD's rules on excessive sales loads unless they chose to bind themselves. However, Commission rulemaking authority in this area is no longer necessary. The SECO program was abolished by legislation in 1983. Pub. L. No. 98-38, § 3, 97 Stat. 206. All broker-dealers now are required to join the NASD unless they effect transactions solely on national securities exchanges, in which case they are regulated by the exchanges. Thus, most of the broker-dealers formerly regulated under the SECO program are now regulated by the NASD, and subject to the NASD's rules on excessive sales loads. Those few that are not regulated by the NASD effect transactions solely on national securities exchanges. Since redeemable investment company securities normally are neither traded nor distributed on exchanges, it is not necessary to have excessive sales load rules applicable to this group. If one of these broker-dealers effected a distribution of an exchange, it would lose its exemption from the requirement of NASD membership, be required to join the NASD, and become subject to the NASD's rules on excessive sales loads.

Section 516(3) would correct an obsolete cross-reference in current section 22(b)(3) of the Investment Company Act, which would be redesignated section 22(b)(2) under the bill. Section 22(b)(3) refers to the Commission's authority to affect the rules of registered securities association, such as the NASD, under section 15A(k)(2) of the 1934 Act. The Commission's authority in this area was moved to section 19(c) of the 1934 Act in the 1975 amendments to that Act. Section 15A(k)(2) no longer exists.

Section 516(4) would amend the first sentence of section 22(e) of the Investment Company Act to make it clear that the seven-day period referred to in the sentence may not be used to suspend redemptions. Rather, an investment company may use the period only to postpone payment or satisfaction upon redemption for up to seven days. A company may suspend the right of redemption or extend the seven-day period for postponements of payments only if one or more of the three conditions specified in paragraphs (1) through (3) of section 22(e) is satisfied. This is the Commission staff's interpretation of the sentence and the interpretation adopted in the *Federal Securities Code* of the American Law Institute. See II American Law Institute, *Federal Securities Code* § 1418(e), at 50 (2d Supp. 1981); Investment Co. Act Release No. 14244 (Nov. 21, 1984), 49 Fed. Reg. 46558 (1984); Investment Co. Act Release No. 10113 (Feb. 7, 1978). The interpretation is supported by a recognized authority in the field. See 3 T. Frankel, *The Regulation of Money Managers* 160-61 (1980).

Section 516(5) would delete as obsolete an exemption in the third sentence of section 22(e) of the Investment Company Act that terminated one-year after the effective date of the Investment Company Act, which was November 1, 1940.

Section 517 would delete as obsolete the provision in section 24(d) of the Investment Company Act which makes available the intrastate offering exemption in Section 3(a)(11) of the 1933 Act for new offerings of securities sold by the issuer or bona fide offered to the public before the effective date of the Investment Company Act.

Section 518 would correct a typographical error in section 26(b) of the Investment Company Act, where the word "intend," instead of the word "intended," is used in what is obviously intended to be the phrase "the purposes fairly intended by the policy and provisions of this title."

Section 519 would correct a typographical error in section 26(c) of the Investment Company Act, where the word "of" is used instead of the word "or" as a conjunction.

Section 520 would correct an error in section 28(a)(2)(B) of the Investment Company Act, where the word "subsection" is used to refer to a paragraph.

Section 521 would correct a typographical error in section 28(d)(2) of the Investment Company Act, where the word "of" is omitted from what is obviously intended to be the phrase "paragraph (2) of subsection (a)."

Section 522(1) would correct a typographical error in section 36(b)(4) of the Investment Company Act, where the word "loans," instead of the word "loads," is used in what is obviously intended to be the phrase "sales loads."

Sections 522 (2) and (3) would redesignate subsection (d) of section 36 as subsection (c) and, within redesignated subsection (c), amend the phrase "subsections (a) through (c)" to read "subsections (a) and (b)." At present, section 36 has a subsection (d) but no subsection (c).

Section 523 provides for redesignating subsection (e) of section 42 of the Investment Company Act as subsection (d), to eliminate the nonconsecutive designation that resulted from the repeal of former subsection (d) by Public Law No. 91-452 in 1970.

Section 524 deletes as obsolete the proviso in section 53 of the Investment Company Act which permitted face-amount certificate companies to register before January 1, 1941, the effective date of the Act's provisions relating to face-amount certificate companies, and declare that such registration would not operate to change or affect the effective date as to the company or any face-amount certificates issued by it.

Sections 525 through 527 would amend sections 54(a), 55(a)(1)(B), and 57(i) of the Investment Company Act, where the word "sections" was used before a citation to a single section of the Act.

TITLE VI

Title VI would effect a number of amendments of the Investment Advisers Act of 1940.

Section 601. See discussion of *Section 102*, above.

Sections 602 (1) and (2) would amend section 203(e) of the Investment Advisers Act to add convictions and injunctions related to transfer agent activities to the list of permissible bases upon which the Commission may impose administrative sanctions on investment advisers and persons associated with investment advisers; the amendment also would conform section 203(e) stylistically to the administrative sanction and disqualification provisions in the 1934 Act and the Investment Company Act. See discussions of *Sections 217 (1) and (2) and 509*, above.

Section 602(3) is a conforming amendment to correct an erroneous cross-reference in subsection (g) of section 203 of the Investment Advisers Act. The error was occasioned by amendments to subsection (d) of section 203, to which subsection (g) currently refers, in 1970 and 1975. Subsection (g) discusses the Commission's authority to deny registration to or revoke or suspend the registration of successors to registered investment advisers. This authority, which is found in subsections (c) and (e), was conferred under subsection (d) before 1970, and the cross-reference was correct. Subsection (d) was redesignated subsection (e) in section 24(c) of the 1970 amendments to the securities laws, however, and the cross-reference in subsection (g) was not altered to conform to the redesignation. See Pub. L. No. 91-547, § 24(c), 84 Stat. 1430. The problem was compounded by the 1975 amendments to the securities laws, which lodged the Commission's authority to deny registration in subsection (c), separating it from the Commission's authority to revoke or suspend registration, which remained in redesignated subsection (e). See Pub. L. No. 94-29, § 29, 89 Stat. 166-68. The proposed amendment would correct the erroneous cross-reference.

Section 603 would reenact present section 205 of the Investment Advisers Act with two major changes. First, the amendment would add new subsection and paragraph designations to section 205 to conform to the accepted usage in other portions of the Act and to make the section easier to read and understand. Several stylistic changes also would be made in connection with this rearrangement. Second, the amendment would conform the language forbidding investment advisers from charging performance fees to retirement plans described in section 3(c)(11) of the Investment Company Act to the clarifying amendments to section 3(c)(11) in *Sections 506 (1) and (2)* of the bill. The language change would make it clear that no investment adviser required to register under the Act may charge a performance fee to a governmental retirement plan. In amending section 205 in 1970, Congress intended to extend the protection of the ban on performance fees in that section to all retirement plans exempt from the operation of the Investment Company Act under section 3(c)(11). See discussion of *Sections 506 (1) and (2)*, above; H.R. Rep. No. 91-1631, 91st Cong., 2d Sess. 31 (1970). Because section 3(c)(11) is being amended to make it clear that all governmental retirement plans described in section 3(a)(2)(C) of the 1933 Act are within the purview of section 3(c)(11), section 205 must be correspondingly amended to refer to all such plans.

It is recommended that section 205 be reenacted in its entirety, with these changes, because confusion has resulted from the 1980 amendments to the Investment Advisers Act over the current form of section 205. Some publishers have printed current clause (C) of

the section after the last sentence, rather than immediately after clause (B) as was intended by Congress. It is hoped that this confusion will end with the reenactment of the entire section with conventional subsection and paragraph designations.

Section 604 provides for redesignating subsection (e) of section 209 of the investment Advisers Act as subsection (d) to eliminate the nonconsecutive subsection designation that resulted from the repeal of former subsection (d) by Public Law No. 91-452 in 1970.

Section 605 would amend section 211(b) of the Investment Advisers Act by replacing a reference to the Federal Register Act with a reference to chapter 15 of title 44 of the United States Code, where the provisions of the Federal Register Act were codified when title 44 was enacted into law in 1968.

Section 606. See discussion of *Section 106(3)*, above.

Section 607. See discussions of *Sections 109(3)* and *304(2)*, above.

REGULATORY IMPACT STATEMENT

In compliance with paragraph 11(b) of Rule XXVI of the Standing Rule of the Senate, the Committee makes the following statement regarding the regulatory impact of the bill. This bill will authorize funds to enable the SEC to carry out its regulatory responsibilities under current law and make technical amendments to the securities laws with no increase in regulatory burden.

CHANGES IN EXISTING LAW

In the opinion of the Committee, it is necessary to dispense with the requirements of subsection 12 of rule XXVI of the Standing Rules of the Senate in order to expedite the business of the Senate.

COST OF LEGISLATION

The Committee has requested a cost estimate of this legislation under the provision of Section 403 of the Congressional Budget Act of 1974. The cost estimate of the Congressional Budget Office appears below:

U.S. CONGRESS,
CONGRESSIONAL BUDGET OFFICE,
Washington, DC, July 1, 1987.

Hon. WILLIAM V. PROXMIRE,
Chairman, Committee on Banking, Housing, and Urban Affairs,
U.S. Senate, Washington, DC.

DEAR MR. CHAIRMAN: The Congressional Budget Office has prepared the attached cost estimate for the Securities Law Technical Amendments Act of 1987.

If you wish further details on this estimate, we will be pleased to provide them.

With best wishes,
Sincerely,

ROBERT F. HALE
(For Edward M. Gramlich, Acting Director).

CONGRESSIONAL BUDGET OFFICE COST ESTIMATE, JULY 1, 1987

1. Bill number: S. 1452.
2. Bill title: Securities Law Technical Amendments Act of 1987.
3. Bill status: As ordered reported by the Senate Committee on Banking, Housing, and Urban Affairs, June 24, 1987.
4. Bill purpose: The bill authorizes \$158.6 million for fiscal year 1988 and \$172.2 million for fiscal year 1989 for the activities of the Securities and Exchange Commission (SEC). In addition, the bill makes numerous technical changes in laws administered by and in operations of the SEC.

Fiscal year 1987 appropriations for the SEC are \$111 million. The amount authorized in the bill for 1988 is \$14 million more than the President's request of \$145 million, and \$38 million more than the CBO baseline level for the agency of \$120 million.

5. Estimated cost to the Federal Government:

[By fiscal year, in millions of dollars]

	1988	1989	1990	1991	1992
Authorization level.....	159	172			
Estimated outlays.....	144	171	16		

Including outlays from prior years' budget authority, total outlays for the SEC in 1988 would be approximately \$154 million, assuming appropriation of the authorized amounts.

The costs of this bill fall within budget function 370.

Basis of Estimate: For purposes of this estimate, it was assumed that the amounts authorized in the bill would be appropriated prior to the beginning of each fiscal year. Outlays reflect historical spending patterns for the ongoing activities of the SEC.

6. Estimated cost to State and local governments: None.
7. Estimate comparison: None.
8. Previous CBO estimate: None.
9. Estimate prepared by Carol Cohen.
10. Estimate approved by James L. Blum, Assistant Director for Budget Analysis.

ADDITIONAL VIEWS OF MESSRS. GARN, D'AMATO, HECHT,
BOND, AND KARNES

While we are generally supportive of the contents of The Report accompanying the Securities and Exchange Commission's (SEC) authorization for fiscal years 1988 and 1989 and the Technical Amendments to the federal securities laws (hereafter referred to as the "Report"), we must strongly object to the criticisms leveled against the SEC in the section entitled "Economic and Policy Analysis." That section of the Report misconstrues the purpose of the SEC's economic research program, the procedures employed to ensure the intellectual and academic integrity of these reports, and the SEC's mission as an independent agency.

Specifically, this section of The Report attempts to express totally unfounded concerns about the procedures governing the SEC's economic research program. Critics of the SEC's research program has inappropriately used the Report to claim that: (1) the SEC does not presently have procedures that assure the "integrity and soundness" of its economic studies; (2) the SEC relies excessively on these economic studies in the formation of its policy; and (3) the SEC may be unwilling to adopt policies to "address problems that are not amenable to econometric measurement." To correct these perceived deficiencies, the Report recommends the adoption of several ill-conceived procedural changes in the conduct of the SEC's economic research. For example, one recommendation would require the SEC to employ a "notice and comment" period during which the public could comment on the relevance of proposed economic studies, the quality of the data to be examined in proposed economic studies, and the appropriateness of the experimental design in proposed economic studies. The Report recommends that all published SEC economic studies contain a summary of the public comments and a discussion of the merits of these comments.

The criticisms the SEC's economic research program contained in the Report suggest a total emancipation from relating the facts concerning the integrity of the SEC's economic research program. The errors contained in the Report are so egregious that they merit immediate rebuttal. First, economic analysis is essential to the formation of public policy in the area of securities regulation. Since securities markets play a critical role in the U.S. economy, the SEC should have the benefit of professional research on the economic effects of proposed legislation and rules concerning our nation's securities markets. Economic analysis of securities markets is among the most highly developed area of professional economic research and it is necessary for the Commission to consider economic arguments in the decision-making process. Contrary to the assertions contained in the Report, the Committee has received little, if any, credible evidence suggesting that the SEC has demonstrated an excessive reliance on economic studies in the development of its

policy. While not all policy issues in the area of securities law are amenable to empirical examination, where economic evidence can contribute to public discussion of a policy issue, the SEC has an obligation to gather, consider, and disseminate this evidence to the Congress and the general public. The SEC has performed this task most admirably. A list of the publicly released SEC economic studies, along with a brief description of each study, is attached to these views. A review of these studies demonstrates the groundless nature of the criticisms contained in the Report.

Second, the Report's comments regarding procedural deficiencies in the SEC's present economic research program lack merit. Therefore, the recommended changes in these procedures are also unfounded. To understand the folly of these criticisms, requires an understanding of the procedures used in the preparation of all SEC economic studies. The economists conducting professional research at the SEC report to the SEC's Chief Economist, who reports directly to the Chairman of the SEC. In many cases the general topics of SEC economics studies are originally suggested by the Chairman, a Commissioner, or another division within the SEC. In addition, the Commission must approve the release of all SEC economics studies.

SEC economists also receive feedback and comments on their studies at various stages in their research from other staff members at the SEC. SEC Commissioners, and other professional economists in academia, business, and other governmental agencies. The SEC economists frequently attend professional economics conferences at which they discuss their pending studies, and their studies generally have been well-accepted in the academic community. Evidence of the quality of SEC economics studies is found in the fact that many of these studies have been published or accepted for publication in professional economics journals. If these studies are subject to varying interpretations or contain methodological flaws, sufficiently strong incentives exist for other economists to offer conflicting evidence in subsequent publications.

The procedures presently employed by the SEC ensure that the SEC economics studies are subject to a peer review process and a cross-fertilization of ideas that enhance their quality. The Report's recommended procedural changes would unnecessarily shackle and chill economic research at the SEC and would impair the SEC's ability to continue to attract well-respected academic economists. Furthermore, it is unnecessary to mandate the public release of all raw data examined by SEC economists in their public studies; these data already are publicly available, and the SEC economics studies already contain all of the necessary information for complete replication.

In summary, we consider it unwise to restrict the procedures presently governing the economic research program at the SEC, and we disassociate ourselves from the criticisms contained in the "Economic and Policy Analysis" section of the Report.

JAKE GARN.
ALFONSE D'AMATO.
CHIC HECHT.
CHRISTOPHER S. BOND.
DAVID K. KARNES.

REVIEW OF STUDIES RELEASED BY THE SECURITIES AND EXCHANGE
COMMISSION'S OFFICE OF THE CHIEF ECONOMIST

1. "Shelf Registration: An Analysis of Intra-Industry Changes in Underwriting Revenues," (June 22, 1987).

This study finds that, on average, the largest broker/dealers experienced significant increases in underwriting revenues relative to total business financing following the adoption of shelf-registration, while smaller firms experienced no significant changes. At the same time, total underwriting revenues were increasing as a percentage of total business financing. In short, the evidence does not suggest that shelf registration has resulted in the demise of regional broker/dealers.

2. "Shareholder Wealth Effects of Ohio Legislation Affecting Takeovers," (May 18, 1987).

This study finds that the passage of the Ohio takeover law resulted in a wealth decrease to shareholders of firms incorporated in Ohio. Even when Goodyear is excluded from the sample of Ohio firms (Goodyear was the subject of a hostile takeover at the time of the law's passage) it is found that the passage of the Ohio law was accompanied by a statistically significant net-of-market decrease in the price of Ohio firms of approximately 1.68 to 3.24 percent. When Goodyear is included in the sample the corresponding net-of-market decrease in share price is 1.84 to 3.42 percent.

3. "Stock Trading Before the Announcement of Tender Offers: Insider Trading or Market Anticipation?" (February 24, 1987).

This study finds a significant increase in the stock price of target firms in 172 successful tender offers in the period before any announcement of the offer. There is a runup in stock prices of 38.8 percent of the total control premium by the close of day *before* the offer announcement. The study also shows that the legal market for information can explain much of the runup. A significant portion of the runup can be explained by three readily identifiable influences on pre-bid trading—media speculation, the bidder's foothold acquisition in the target, and whether the bid is friendly or hostile.

4. "Potential Competition and Actual Competition in the Options Market," (November, 1986).

This study empirically examined some economic assessment of the options allocation plan. Using the bid ask spread as a measure of transaction cost, the study finds that options eligible for multiple listing have significantly lower spreads than single listed options.

5. "The Effects of Poison Pills on the Wealth of Target Shareholders," (October 23, 1986).

This study examines the 245 poison pills adopted between 1983 and July 4, 1986. In the 30 pill cases involving control contests nearly half of the targets defeated takeovers, a rate much higher than for other defensive tactics. For the full sample of 245 pills, the introduction of poison pills reduced the stock prices of the firms implementing the pills by 1.7 percent, net-of-market. The stock price decline is greater for discriminatory pills.

6. "The Effects of the SEC's Full-Cost Ruling and Write-Downs on the Stock Prices of Oil and Gas Firms," (October 1, 1986).

This study supports the view that the SEC's decision to retain the use of the current market price of oil in the ceiling test computation caused no significant effects on the market value of oil firm equity. The stock price evidence revealed that the market devalued the equity of oil firms' common equity before the SEC decision. In essence, the capital market made its own stock price writedowns in anticipation of reduced earnings as oil prices fell, not when the SEC decided to reaffirm a rule which would force some accounting writedowns.

7. "Noninvestment Grade Debt as a Source of Tender Offer Financing," (June 20, 1986).

The aggregate data on tender offer financing from 1981 through June 1985 support many of the perceptions about the changing role of junk bonds in tender offer activity. As a percentage of total tender offer financing, junk bonds increased from 0.3 during 1981-1984 to 13.6 during the first six months of 1985. The percentage of total tender offer financing accounted for by bank borrowing changed negligibly over this time period from 78.6 percent during 1981-1984 to 77.6 percent during the first six months of 1985. The use of junk bond financing is found to predominate in large, hostile tender offers.

8. "Shark Repellents and Stock Prices: The Effects of Anti-takeover Amendments Since 1980," (July 24, 1985).

This paper examines the effects on shareholder wealth of anti-takeover amendments proposed between 1979 and 1985. The evidence indicates that the introduction of these amendments was accompanied by a net-of-market stock price decline of 1.31 percent. This conclusion is excessively broad when the data are broken down by different kinds of shark repellents. The more restrictive type of amendments have greater stock price declines, but the most harmful type of shark repellents studied are becoming increasingly obsolete.

9. "The Economics of Any-of-All, Partial, and Two-Tier Tender Offers," (April 19, 1985).

This study examines 228 tender offers between 1981 and 1984. It finds that any-or-all offers are more frequent than two-tier offers and the relative incidence of any-or-all offers is growing. The evidence also suggests that the blended premiums in two-tier offers (55%) are almost as high as in any-or-all offers (59.6%) indicating that two-tier offers are not less beneficial to target firm shareholders than any-or-all offers.

10. "Institutional Ownership, Tender Offers, and Long-Term Investments," (April 19, 1985).

This study of 324 high research and development firms and of all 177 takeover targets during 1981-1984 shows evidence that: (1) increased institutional stock holdings are not associated with increased takeovers of firms; (2) increased institutional holdings are not associated with decreases in research and development; (3) firms with high research and development expenditures are not more vulnerable to takeovers; and (4) stock prices respond positively to announcements of increases in research and development expenditures.

11. "Eurodollar Bonds: Alternative Financing for United States Companies," (June 26, 1985).

This study examines interest rate relationships between Eurodollar and the domestic bond market. The conclusions of the study are that on average, Eurodollar bond issues have higher borrowing costs than similar domestic issues, and that the primary source of higher borrowing cost is the higher underwriting cost associated with a Eurobond sale. There is no difference in the reoffer yields for similar securities between the two markets and the Eurodollar bond borrowing costs are affected by the exchange rate between the dollar and foreign currencies, and the degree of market congestion in the Eurodollar bond market.

12. "Explaining the Savings from Rule 415: The Debt Market," (September 17, 1984).

This study finds that industrial bond issues sold by shelf registration sell for about 20 basis points less than similar nonshelf sales. The differences in interest cost between the two methods of sales are accounted for by the intensity of bidder competition for the bond issues. These results provide empirical support for the Commission's adoption of Rule 415.

13. "The Impact of Targeted Share Repurchases (Greenmail) on Stock Prices," (September 11, 1984).

This study examines a sample of targeted block stock repurchases including 89 cases of large repurchases (blocks greater than three percent of the outstanding common stock) during 1979-1983. The initial announcement of investor interest induces a positive return averaging 9.7 percent, while the greenmail transaction is associated with a stock price loss of 5.2 percent.